THE LIBERALIZATION OF TRADE IN TELECOMMUNICATIONS SERVICES

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PhD

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Abstract

Trade in services is central to the world economy today. Telecommunications services, in particular, can be traded directly as well as providing a medium through which goods and other services can be traded. They are therefore critical to development and the expansion of world trade.

This thesis provides a legal analysis of the liberalization of trade in telecommunications services through the multilateral framework of the General Agreement on Trade in Services (GATS). More specifically, it examines the interplay of multilateral rules and the domestic regulation of telecommunications in the context of the World Trade Organization (WTO), the US, and India.

The telecommunications industry has until recently been heavily regulated. Even in the US, the movement towards deregulation began only in the 1970s. An in depth examination of the US telecommunications industry in Chapter 2 provides a background analysis of the origin of policies on liberalization of telecommunications domestically and internationally. Chapter 3 examines the current importance of the service economy and the decision of the developed countries, in particular the US, to expand trade in services through liberalization. Chapters 3 and 4 illustrate the extent to which developed countries were the driving force for a multilateral framework within the WTO to govern trade in services, including telecommunications. Chapter 5 shows that developing countries, such as India, although demonstrating their recognition of the benefits of telecommunications liberalization through autonomous regulatory reforms, have so far been restrictive in their WTO services commitments.

From this study, it is clear that the movement in both developed and developing countries is towards liberalization and competition. More specifically, the thesis demonstrates the extent to which trade liberalization together with domestic regulatory reform are necessary in order to achieve the liberalization of trade in telecommunications services.

Table of Contents

List of Abbreviations

ABT	Agreement on Basic Telecommunications
AT&T	American Telephone and Telegraph Company
BOC	Bell Operating Company
BSNL	Bharat Sanchar Nigam Limited
BT	British Telecommunications
CCI	Communications Commission of India
Cofetel	Comisión Federal de Telecomunicaciones (Federal Telecommunications Commission)
CSC	Committee on Specific Commitments
CTS	Council for Trade in Services
DOJ	Department of Justice
DoT	Department of Telecommunications
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
FCC	Federal Communications Commission
FRC	Federal Radio Commission
FTC	Federal Trade Commission
FTL	Federal Telecommunications Law 1995
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GBT	Group on Basic Telecommunications
GNS	Group on Negotiations on Services
ICC	Interstate Commerce Commission
ILD	International Long Distance
ILEC	Incumbent Local Exchange Carrier
IMF	International Monetary Fund
IMTS	International Message Telephone Service
ISP	Internet Service Provider
ITU	International Telecommunications Union
LATAs	Local Access and Transport Areas
LDC	Least-Developed Country
LLU	Local Loop Unbundling
MCI	Microwave Communications, Inc.
MFJ	Modification of Final Judgment
MTNL	Mahanagar Telephone Nigam Limited
MTS	Message Toll Service
NGBT	Negotiating Group on Basic Telecommunications
NLD	National Long Distance
NRA	National Regulatory Authority
NTP	National Telecom Policy
Ofcom	Office of Communications
Oftel	Office of Telecommunications
PSTN	[Public Switched Telephone Network]
PTT	Posts, Telephone and Telegraph
PTTNS	Public Telecommunications Transport Networks and Services
PUC	Public Utilities Commission
RBOC	Regional Bell Operating Company
SCT	Secretaría de Comunicaciones y Transporte (Secretariat of Communications and Transportation)
TPR	Trade Policy Review

TRAI	Telecom Regulatory Authority of India
TPRB	Trade Policy Review Body
TRIPS	[Trade Related Aspects of Intellectual Property]
USTR	Office of the United States Trade Representative
VCLT	Vienna Convention on the Law of Treaties 1969
VSNL	Videsh Sanchar Nigam Limited
WGTCP	Working Group on the Interaction Between Trade and Competition Policy
WGTS	Working Group on Telecommunications Services
WPDR	Working Party on Domestic Regulation
WTO	World Trade Organization

List of GATT and WTO Cases

GATT, *Italian Discrimination against Imported Agricultural Machinery*, BISD 7S/60, 64, L/833, adopted 23 October 1958.

GATT, Panel Report, *Spain – Tariff Treatment of Unroasted Coffee*, adopted on 11 June 1981, BISD 102 (1982).

GATT, *United States – Taxes on Petroleum and Certain Other Imported Substances*, BISD 34S/136, L/6175, adopted 17 June 1987.

GATT, Panel Report, *United States – Section 337 of the Tariff Act of 1930*, adopted on 7 November 1989, BISD 36S/345.

GATT, Panel Report, *Japan – Tariff on Import of Spruce-Pine-Fir (SPF) Dimension Lumber*, adopted on 19 July 1989, BISD 167 (1990).

WTO, *Japan – Taxes on Alcoholic Beverages*, Panel Report (WT/DS8/R, WT/DS10/R, WT/DS11/R), Appellate Body Report, (WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R), adopted 1 November 1996, p. 20.

WTO, *Canada – Certain Measures Concerning Periodicals*, Panel Report, WT/DS31/R, and Appellate Body Report, WT/DS31/AB/R, adopted on 30 July 1997.

WTO, *European Communities – Regime for the Importation, Sale and Distribution of Banana*, Panel Report (WT/DS27/R/ECU, WT/DS27/R/GTM, WT/DS27/R/HND, WT/DS27/R/MEX, WT/DS27/R/USA) and Appellate Body Report (WT/DS27/AB/R), adopted 25 September 1997.

WTO, *Canada – Certain Measures Affecting the Automotive Industry*, Panel Report, WT/DS139/R, WT/DS142/R, and Appellate Body Report, WT/DS139/AB/R, WT/DS142/AB/R, adopted 30 June 2000.

WTO, *Mexico – Measures Affecting Telecommunications Services*, Panel Report, WT/DS204/R, adopted 1 June 2004.

WTO, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, Report of the Panel, WT/DS285/R, released 10 November 2004 (not yet adopted - US appealed to the Appellate Body on 7 January 2005 (WT/DS285/6, 13 January 2005)).

Chapter 1

Introduction

"Markets, like freedom, work well only within a suitable framework of rules."[1]

This thesis provides a legal analysis of the liberalization of trade in telecommunications services through the multilateral legal framework of the General Agreement on Trade in Services (GATS). It examines the implementation of the rules-based system of the World Trade Organization (WTO) on telecommunications specifically within the domestic legal systems of the United States and India, but draws more generally a number of implications for the interplay between multilateral rules and domestic policies on telecommunications services.

Liberalization of trade in services was incorporated into the multilateral rules-based system of the WTO at the end of the Uruguay Round of GATT multilateral trade negotiations in 1994. Services encompass many different varieties and sectors. In particular, the telecommunications service sector is an important backbone of every economy and is indispensable to trade: telecommunications services provide the underlying means through which trade in other services and goods can be traded as well as being an economic activity that is tradable in its own right.

A treaty of legally binding rules governing world trade in services was drawn up as the GATS, forming one of the WTO Agreements. The GATS is

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[1] Maria Livanos Cattaui, "Trade rules after Seattle: A business perspective," in *The Role of the World Trade Organization in Global Governance* (Sampson, ed.) (United Nations University Press: 2001), p. 259.

intended to reduce barriers to trade in services and ensure the transparency of government regulations and other government measures affecting trade in services. Its central purpose is to ensure the progressive liberalization of services sectors and trade in services.

The Agreement on Basic Telecommunications (ABT), attached as the Fourth Protocol to the GATS,[2] is a product of the extended negotiations on trade in services that took place after the conclusion of the Uruguay Round, as part of the struggle to achieve greater market access commitments in important specific sectors such as telecommunications and financial services. In addition, the negotiations on basic telecommunications produced a set of regulatory and pro-competitive principles known as the Reference Paper. The GATS, the Fourth Protocol and the Reference Paper provide the main WTO legal instruments governing the liberalization of trade in telecommunications services.

The liberalization of trade in services through the multilateral framework of the WTO has, since its introduction to the negotiating tables by the US during the early stages of the Uruguay Round, continuously attracted fiery debates among trade negotiators, government officials, economists, lawyers, and academics in both developed and developing countries due to its controversial and inevitable attribute of interfering with policies and measures normally reserved for domestic authorities. This thesis will analyse the debates surrounding the liberalization of trade in services, with particular reference to telecommunications, looking at the merits and difficulties of such liberalization.

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[2] The ABT is the commonly used but unofficial name given to the Fourth Protocol to the GATS. The ABT contains the schedules of commitments negotiated and tabled at the end of the extended negotiations on basic telecommunications. The "Agreement on Basic Telecommunications" or ABT will be used throughout this thesis when referring to the Fourth Protocol and the attached schedules.

I. The Scope and Objective of the Thesis

The aim of the thesis is to examine the regulatory framework on telecommunications services within the national regimes of the US and India and to determine how and to what extent these WTO Member States have implemented the liberalization rules and principles of the GATS. Examples are also drawn from the EU and the UK where relevant.

As a result of this in depth study into the liberalization process both internationally and domestically, this thesis seeks to establish how the implementation of the liberalization of trade in telecommunications services should work under the GATS and to provide practical suggestions for countries liberalizing their telecommunications services sectors in compliance with the rules and principles of the GATS. The thesis also examines the practical implications of liberalization.

This requires us to look also at the history of the negotiations that led to the creation of the GATS in order to ascertain the concerns of developing countries and to understand the perspective of developing countries in the liberalization process of trade in telecommunications services.

II. Structure of the Thesis

The thesis begins, in Chapter 2, with an in depth examination into the telecommunications industry of the United States, and in doing so this first substantive chapter sets the scene for the following chapters. The US is unique in that from the beginning its telecommunications industry was run by private operators. Although from the 1930s until the 1980s the law authorized AT&T, the major US telecommunications provider, to operate as a monopoly, it remained in private hands. This was in contrast to the rest of the world where state-owned companies operated most telecommunications industries. The US was the first industrialized country to liberalize its telecommunications sector and introduce deregulation and competition and this is why it is of importance to our enquiry into liberalization that is now taking place within the WTO context. It also spear-headed the liberalization of telecommunications services in international trade through the forum of the WTO. Examinations of US domestic regulation of the telecommunications sector and its international policies on trade in telecommunications services provide a background analysis of the origin of policies on liberalization of telecommunications services both domestically and internationally.

Chapter 3 analyzes the services sector and traces the development of its growth into an important economic activity, particularly in the US, and more importantly the growth of trade in services. This chapter examines the liberalization process of trade in services from the first acknowledgment of this economic sector as tradable in the US Trade Act of 1974, to its inclusion on the agenda of the Uruguay Round of GATT multilateral trade negotiations and finally to its first international agreement as part of the framework umbrella of the newly established WTO. The chapter demonstrates once again the US's role and leadership in the liberalization of trade in services through the multilateral channel of the GATT and WTO. Furthermore, the chapter analyzes the GATS provisions and their application to the liberalization of telecommunications services.

Chapter 4 examines the liberalization of trade in telecommunications services within the context of the WTO, particularly concentrating on the relevant provisions of the GATS, the Annex on Telecommunications and the Reference Paper. To this end, it looks at the first WTO case on telecommunications services (which involved the US and Mexico) before a WTO panel,[3] and analyzes the Panel's interpretation of the GATS and its application to the liberalization of trade in telecommunications services. The chapter discovers that the Panel decision has important implications for both developed and developing countries with regard to both international and domestic aspects of telecommunications services liberalization and the extent of commitments developing countries are likely to make in the current WTO round of trade negotiations.

Chapter 5 studies the telecommunications industry in India and offers insight into the development and circumstances of the liberalization of telecommunications in a fast-growing developing country. The chapter finds that the Indian government has been keen to embrace reforms introducing competition into the telecommunications sector. However, the new bill on communications is still very restrictive and continues to maintain heavy government involvement in most aspects of the telecoms industry. India has made limited commitments in basic telecommunications within the WTO at the end of the Uruguay Round and the extended negotiations on basic telecommunications. Furthermore, although India has undertaken autonomous liberalization in the telecommunications sector *vis-à-vis* its obligation to the WTO, it has, in its recent offers on trade in services in the current Doha Round tabled at the

[3] WTO, *Mexico – Measures Affecting Telecommunications Services*, Panel Report, WT/DS204/R, adopted 1 June 2004.

WTO on 16 December 2003, scheduled very few of these autonomous measures as commitments.[4]

Finally, the conclusion advances some policy implications and conclusions drawn from the analyses in the substantive chapters.

III. Methodology

The methodology used in this thesis includes the reviewing and analyzing of the literature on telecommunications law, international economic law, particularly on the WTO and the GATS, and general public international law. The categories of literature included journal articles, newspaper articles, books, economic studies, official documents, treaties and legislations. In examining the domestic frameworks on telecommunications, legislation, legal instruments and case law of the US, India, the EU and the UK were consulted. As for the study of the legal system of the WTO, the process involved analyzing the complex layers of GATS Articles, its annexes on telecommunications, the Fourth Protocol to the GATS, schedules of Members' commitments on market access, national treatment and additional commitments, the Reference Paper, as well as other relevant WTO Agreements, and WTO case law. The thesis compares and contrasts the domestic and international legal systems in the context of the liberalization process of telecommunications services.

[4] The main method of services negotiations in the WTO is the request and offer process, under which each country tables its demands from its trading partners and its offers to its trading partners in specific sectors.

Chapter 2

From Regulation to Liberalization: US Leadership in Telecommunications

The United States as the country where the telegraph and the telephone was invented consequently became the leader in the advancement of the telecommunications industry.[1] For fifty years after the invention of the telephone, alternating periods of heavy competition and monopoly control characterized the operation of the industry. In the 1930s, the risk of market failure in this service industry led the US government to deliberate on the correct regulatory response: whether to regulate it as a monopoly, nationalize it or maintain the status quo which at the time consisted of operation under market forces without any government regulation. The US government under Franklin D. Roosevelt chose the first option. The US is thus the origin of today's modern form of state regulation whereby the operation of the telecommunications industry is left in private hands but at the same time is overseen by an independent government regulator.

In contrast, European countries chose to nationalize their telecommunications industries after initial periods (shorter than in the US) of provision by competing private companies.[2] As a result, 'regulation' of the telecommunications industry in Europe took the form of state-owned

[1] The US is the world's largest telecommunications services market and among the most competitive. WTO, *Trade Policy Review: United States*, Report by the Secretariat, WT/TPR/S/88, 15 August 2001, p. 111.

[2] This was particularly the case in the United Kingdom. See Hall, Scott and Hood, *Telecommunications Regulation: Culture, Chaos and Interdependence Inside the Regulatory Process* (2000), Chapter 2; Oftel, "Oftel's five minute guide to the history of telecommunications regulation in the UK", *Oftel News*, Issue No. 60, June 2003, pp. 6-7.

enterprise run by the government.[3] Though the United Kingdom adopted an independent regulatory approach to telecommunications in the early 1980s, the US form of regulation only first appeared in mainland Europe in the early 1990s. Consequently, the US is more experienced in this form of governmental regulation than Europe.

In addition, 'deregulation' and the process of opening the telecommunications industry up to competition first developed in the US. This process led to the divestiture of the American Telephone and Telegraph Company (AT&T), the US telecommunications monopoly provider, in 1984 and the emergence of a new era in the evolution of the industry. Since the divestiture, the US government has adopted pro-competitive and liberalizing policies both domestically and internationally. Furthermore, the US has taken a very active and influential role in bringing these policies to the forefront of the multilateral trading system of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO).

The US was the main driving force behind the first multilateral framework on trade in services.[4] It has also been responsible for the creation for the first time of a specific multilateral framework of rules governing telecommunications services.[5] In particular, the US's domestic laws and policies on the liberalization of telecommunications services – based on transparency, non-discrimination, competitive safeguards, independent regulator and cost-oriented rates – have been transplanted

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[3] See Giandomenico Majone, *De-regulation or Re-regulation: Regulatory Reform in Europe and the United States* (1990); G. Majone, "The Rise of the Regulatory State in Europe", 17 *Western European Politics* (1994), pp. 77-101.
[4] The General Agreement on Trade in Services (GATS). See Chapter 3.
[5] See Chapter 4.

into the WTO Agreement on Basic Telecommunications (ABT).[6] For all the above reasons, this chapter, in exploring the liberalization process of trade in telecommunications services, examines the US telecommunications industry from its birth in the nineteenth century to the present day. The focus is on the government's regulatory policies in both domestic and international arenas and the leadership of the US in the regulation and liberalization of the telecommunications sector.

I. A Brief History of the US Telecommunications Industry: the Early Years 1876-1920s

The telecommunications industry began with the inventions of the telegraph in 1837 and the telephone in 1876.[7] These two significant events brought about a revolution in the transmission of information; the new services made it possible to relay information more quickly and over a much greater distance than existing means, like the postal service and written or printed publications.[8] On 14 February 1876, Alexander Graham Bell filed the original patent for the telephone, or more precisely, an improvement on the telegraph in the form of a 'talking telegraph'. On the same day, but a few hours later, Elisha Gray filed a notice of intent to apply for a patent on a device that could convey speech. This earlier filing

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[6] See Chapter 4.
[7] For sources on the early history of the telecommunications industry, see N.R. Danielaian, *AT&T: The Story of Industrial Conquest* (1939); John Brooks, *Telephone : The First Hundred Years* (1975); Sidney H. Aronson, "Bell's Electrical Toy: What's the Use? The Sociology of Early Telephone Use" in *The Social Impact of the Telephone* (Ithiel de Sola Pool (ed.)) (1977); Anton Huurdeman, *The Worldwide History of Telecommunications* (2003) is particularly comprehensive and an interesting read.
[8] Historical accounts show that Samuel Morse, an American, was the person usually credited with the invention of the electrical telegraph; hence, the statement that the US is the birthplace of the telegraph. However, his invention was built upon earlier experiments, conducted in Europe and the US.

by Bell, the basis for which the US Patent Office awarded Bell, not Gray, the patent for the telephone,[9] became the focus of hundreds of law suits, and the pivotal event that gave birth to the telephone company that would grow and be known across the world.[10]

The telecommunications industry in its early years developed without government regulation. From 1876 to the 1920s, the evolution of the telephone industry consisted of alternating periods of competition and monopoly. For the first two years after its invention, the telephone was a battle between Western Union and the Bell Telephone Company. This section and the following subsections will examine the US telecommunications industry prior to the creation of a systematic form of federal regulation which began with the Communications Act 1934.

1. *Beginnings of the Telephone Industry: Bell Telephone v Western Union*

Western Union, originally the New York and Mississippi Valley Printing Telegraph Company, was created in 1851 to provide telegraphic communications in the US. It built the US's first transcontinental telegraph line in 1861 and became the most powerful telegraph company of the era.[11] Meanwhile, Bell and his two financial backers, Gardiner Hubbard and Thomas Sanders, formed the Bell Telephone Company on 9 July 1877. The Bell Telephone Company started off with only two full-time

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[9] The award was also based on the distinction between a notice of intent and an actual patent application. The US Patent Office issued a patent to Bell on 7 March 1876. Bell received a second patent in 1877 for the telephone, covering the combined receiver-transmitter instrument and its various mechanical features.

[10] This company is the American Telephone and Telegraph Company (AT&T) which began life as the Bell Telephone Company in 1877.

[11] Adam Thierer, "Unnatural Monopoly: Critical Moments in the Development of the Bell System Monopoly", 14(2) *The Cato Journal* (Fall 1994).

employees and there was no comparison between it and Western Union, which had grown into a corporate giant by then, in terms of size and operation.

Due to the poor prospects of the newly formed Bell Company, Gardiner Hubbard, in the autumn of 1877, offered to sell to Western Union all rights to the telephone for $100,000. Fatally, as viewed with hindsight, William Orton, President of Western Union, rejected what he considered to be a mere ' electrical toy', believing the device was nothing more than a passing novelty. However, only a few months after, Western Union realized they had made a mistake when customers for the telegraph company's stock ticker service were busily ordering telephones. Western Union bought Elisha Gray's telephone patents and challenged Bell patents on the basis of its ownership of Elisha Gray's work. This set the stage for a major corporate battle between Western Union and the fledgling Bell Company, and marked the first competitive period in US telecommunications.

The telecommunications industry in its early years was left to develop according to market forces and patent laws. Emerging telephone companies, particularly Bell and Western Union, competed for businesses and developed strategies that brought them into conflict. There was no government agency to intervene, and disputes were settled by the courts. When a company began gaining control of virtually all sectors of the industry, for instance when Bell Telephone acquired a controlling interest in Western Union, anti-trust law kicked in to check the company by preventing the rise of monopolistic and restrictive practices in the telecommunications industry.[12]

Once it had acquired Gray's patents, Western Union embarked on a patent suit against Bell Telephone. This resulted in a key victory for Bell when Western Union concluded an out-of-court settlement in 1879. Western Union, believing Bell would win the trial, agreed to a contract which surrendered all of its patents, claims and facilities in the telephone business in exchange for $325,000 and 20 per cent of Bell telephone rental receipts over the 17-year life of the Bell patents. Western Union also agreed, during the life of the contract, to confine its message-transmitting activities to the telegraph field. In return, Bell agreed to stay out of telegraphy. The agreement effectively set up Bell Telephone Company as the telephone monopoly and gave Western Union the monopoly in telegraphy. This agreement, which lasted until 1894 when the Bell patents expired, consequently ended the brief, albeit vigorous, early period of telephone competition.[13]

2. Bell Monopoly: 1879 – 1894

By 1885, the Bell Telephone Company succeeded in integrating vertically,[14] forming relationships with the operating companies licensed under its patents. In 1882, Bell bought a controlling interest in the Western Electric

[12] See Section I.4 below on the Wilson administration's proposed anti-trust action against the Bell System and the Kingsbury Commitment.
[13] Both Bell Telephone and Western Union aggressively expanded telephone development during 1878 in attempts to compete with one another. See R. Horwitz, *The Irony of Regulatory Reform* (1989), p. 97; Charles Brown, "The Bell System", *Encyclopedia of Telecommunications*, (1991); Huurdeman (2003), p. 188.
[14] A firm is vertically integrated when it controls the complete range of manufacturing, sales, and services of a product.

Company, an equipment supply arm of Western Union, which became the principal manufacturer of Bell telephone equipment; and in 1885, created a subsidiary, the American Telephone and Telegraph Company (AT&T), to operate its long-distance system.[15] Bell Telephone, reconstituted as the American Bell Telephone Company in 1880, gradually acquired most of its licensees and collectively the enterprise became known as the Bell System.[16]

The monopoly period from 1879 to 1894 was very profitable for Bell. By 1895, Bell's revenue was 98 per cent that of Western Union's.[17] The monopolistic empire of the Bell system was also built on the aggressive method of using patents held by Bell companies, particularly American Bell, to sue other companies that attempted to offer telephone service. The agreement signed by Western Union and Bell in 1879 did not restrict other independent companies from attempting to set up telephone businesses and enter the market that Bell had created. Thus, although Western Union no longer posed a threat to Bell, there were other competitors trying to provide telephone services. However, Bell, as holder of all patents to the telephone, thwarted competition. In the 1880s, Bell won all 600-plus infringement lawsuits brought to enforce its patents. Until the expiration of the agreement, and its patents, in 1894, only Bell Telephone and its licensees could legally operate telephone systems in the US.

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[15] By the end of the year, AT&T completed its first line, between New York and Philadelphia. The initial capacity of the line was one call at a time. See http://www.att.com/history.

[16] The Bell System consisted of AT&T, 22 Bell Operating Companies, Western Electric and Bell Laboratories (set up in 1925).

[17] Herring and Gross, *Telecommunications: Economics and Regulation* (1936), p.47; G.W. Brock, *The Telecommunications Industry: The Dynamics of Market Structure* (1981), p. 108.

During this monopoly, the Bell System grew into a formidable enterprise. For the most part, however, it did not attempt to beat the early competitors by offering cheaper and better services.[18] The Bell monopoly era was characterized by limited growth of service. In fifteen years, telephones per 1,000 people grew from 1.1 in 1880 to only 4.1 in 1894.[19] In contrast, in the fifteen-year period of vigorous competition that followed, telephones per 1,000 people grew from 4.8 in 1895 to an impressive 82.0 in 1910.[20] These early periods in the history of the US telecommunications industry reveal the contrast during the monopoly period, on the one hand, and competitive years, on the other, in the growth of the telephone industry in terms of number of telephones and the extent of services provided. It was clear that competition, not monopoly, yielded economic benefits to the industry and to consumers.

3. *Fiercely Competitive Years: 1894-1907*

The monopoly status enjoyed by the Bell Company during the life-span of the 1879 agreement it had entered into with Western Union ended with the expiry of that contract. After 1894, a period of very active competition began once again.[21] It was described, in 1934, to be "one of the most

[18] Brooks (1975). This would change when vigorous competition, once again, forced Bell to invest in research that would improve the quality of telephony.

[19] Bureau of the Census, *Historical Statistics of the United States: Colonial Times to 1970*, (Washington, D.C.: US Government Printing Office, 1975), Vol. 2, Series R-2, p. 784, as quoted in G. W. Brock, *Telecommunication Policy for the Information Age: From Monopoly to Competition* (1994), p. 63.

[20] L.S. Hyman, R.C. Toole and R.M. Avellis, *The New Telecommunications Industry: Evolution and Organization*, Vol. 1 (Public Utility Reports, Inc., 1987), p. 93, as quoted in Thierer (1994).

[21] By the end of 1894, over 80 new independent competitors had already captured 5 per cent of the total market share. G.W. Brock (1981), p. 112.

violent competitive periods any industry ever had in the United States."[22] Those competitive years, especially from 1894 to 1902, would prove beneficial to the telephone industry in terms of the great increase in telephone installations.

When Bell's fifteen-year agreement ended in 1894, there were less than 300,000 telephones in use.[23] In contrast, during the eight years of vigorous competition, the independent telephone companies installed almost a million telephones, and Bell, in response, installed another million.[24] From 1902 to 1907 growth was more active than ever before, with the independent companies having installed 2 million telephones and Bell installed almost 2 million more.[25] These competitive years proved valuable to the expansion of the telephone industry in providing services for the population across the US. By 1912, there were 8.7 million telephones in use: one phone for every 11 people. This was more per capita than in any European country in 1934, except Denmark and Sweden.[26]

While people across the US were benefiting from the growth in telecommunications services, the Bell System was faced with extensive competition. Between 1894 and 1904, over six thousand independent telephone companies entered the telephone business.[27] These competitors

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[22] Statement of Dr. David Friday, U.S. House of Representatives, 73rd Congress, 2d Session, Committee on Interstate and Foreign Commerce, Hearings on H.R. 8301: *A Bill to Provide for the Regulation of Interstate and Foreign Communication by Wire or Radio, and for Other Purposes*, May 15, 1934.
[23] *Ibid.*, p.259.
[24] *Ibid.*, p.260.
[25] *Ibid.*
[26] *Ibid.*
[27] AT&T: A Brief History at http://www.att.com/history.

grew by servicing areas not served by the Bell System, but then quickly began invading AT&T's territory, especially where Bell service was poor.[28]

Fierce competition prompted the Bell System to seek a better position in the telephone industry through more lenient laws for raising capital, which was desperately needed to finance its growth as competition intensified. As American Bell, the parent company, was restricted by the laws of Massachusetts where it was established (which required the legislature to approve corporate plans to raise capital and where companies were restricted in their ownership of subsidiaries), it decided to transfer its assets to the New York-established AT&T in 1899. AT&T thus became the parent company of the Bell System.

The vigorous competition throughout this period forced Bell to develop new policies. For instance, it began sublicensing some independent exchanges, and in effect brought them into the Bell System. In areas where Bell-licensed companies were confronted with competition, the Bell companies cut telephone rates. It greatly expanded its operating plants and established new exchanges, often resulting in head-to-head competition with independents in various cities. Its long-distance network was its single most significant advantage. AT&T thus sought to expand its long-distance service in order to press its system advantage over isolated competitors, and acquired strategically located independent exchanges. Bell also used its political influence and financial power to curb the growth of independents – refusing to interconnect independent telephone companies into its long-distance or local networks except where Bell could benefit from such interconnection. It also prohibited Western Electric

[28] Thierer (1994).

from supplying equipment to independent companies.[29] But despite Bell's tactics and its competitive advantage the independents came to control around 50 per cent of all telephones at the height of the competitive years.[30]

Although the Bell System had grown into a dominant market player and developed into an integrated system, its financial situation was precarious. Aggressive competition left AT&T effectively out of funds by 1906-1907, forcing it to curtail virtually all licensee capital expenditure programmes.[31] The competitive years had taken a toll on the former monopoly provider; one man would step in and set the course of the telecommunications industry for the next seventy years.

4. *AT&T's Emerging Dominance: Theodore Vail, the Mastermind*

Theodore Vail returned for his second term as president of AT&T in April 1907.[32] He immediately set about strengthening AT&T's position by changing its fundamental focus from competition to consolidation, believing in the superiority of a single telephone system. Vail's mission was to make AT&T the monopoly telephone company. In 1908, as part of AT&T's national advertising campaign, he introduced the slogan "One System, One Policy, Universal Service". To achieve his vision, Vail adopted a vigorous plan of acquisitions, internal reforms of the Bell System, refusing interconnection and working with the government.

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[29] On Bell policies during the competitive years, see Brown (1991) and Horwitz (1989), p. 98.
[30] Horwitz (1989), p. 98.
[31] Brown (1991).
[32] His first term as president was from 1885-1887 when AT&T was newly formed. He was sixty-two when he returned to AT&T in 1907.

Bell's acquisition policy had begun with the expiration of its basic telephone patent in 1895, and was pursued particularly aggressively during Vail's leadership. AT&T acquired independent competitors which became operating subsidiaries of the Bell system. Furthermore, it also managed, at one time, to secure a controlling interest in Western Union, the nearest thing to a long-distance competitor. Only under threat of an antitrust suit did AT&T agree to divest itself of its Western Union holdings.[33]

Vail also strengthened the company internally. He launched a major reorganization of operations into three functional departments – plant, commercial and traffic – and set about standardizing equipment. Bell operating companies were no longer permitted to direct Western Electric to manufacture equipment to their own specifications. Standards were also set for operating procedures throughout the Bell System. Technological success in the Bell System also enhanced its standing in the market place. In January 1915, AT&T completed and opened the first US transcontinental line,[34] and in October of the same year, they made the first call across the Atlantic.[35] Vail made research and development in the Bell System a priority and effectively modernized it.[36]

The strength and size of AT&T might lead to the mistaken assumption that its telephone system covered most of the geographical

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33 See below on the 1913 anti-trust suit against AT&T.

34 The service was available to all telephone customers, but at the initial price of $20.70 for the first three minutes between New York and San Francisco – volume was low. Brown (1991); AT&T History at http://www.att.com/history .

35 However, full transatlantic telephone service did not begin until 1927, which was initially between the US and London. The conversations crossed the Atlantic via radio and the initial capacity was one call at a time, at a cost of $75 for the first three minutes. AT&T History at http://www.att.com/history.

36 In 1925, Bell established Bell Telephone Laboratories Inc. as its research and development subsidiary.

area of the US. Bell, however, had built its system in metropolitan centres only, thus allowing demand in small towns and rural areas to induce new entrants.[37] The Bell system, however, was the most successful by reason of its aggressive acquisition policies and the strengthening of its internal operations. The primary issue, however, was interconnection. Interconnection is the linking or connecting of two telecommunications carrier networks for the mutual exchange of traffic.[38] AT&T refused to interconnect the independent carriers to its networks.

Consequently, although the US was provided with a proliferation of telephones during the competitive years which gave even remote rural areas access to the telephone, the separate systems were not connected to each other due to AT&T's obstructive behaviour. Part of the trouble was that rival telephone systems were constructed to different technical specifications because of AT&T's unwillingness to license its patents. This meant that Bell customers could only talk to other Bell customers, while a business that wanted a line to a wide range of customers needed to subscribe to more than one telephone company. Some state legislators attempted to require interconnection, but AT&T fought in court and generally won.[39]

At the time, no government agency with the appropriate powers existed to require AT&T to allow other competitors to interconnect to its systems. This made it possible for AT&T to grow into a powerful

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[37] Brock (1994), p. 65.
[38] See US Code of Federal Regulations, Title 47, 47 CFR Ch. 1 Section 51.5 (October 1, 2003 edition), available at http://wireless.fcc.gov/rules.html. Interconnection is also defined as the "connection of a piece of telephone equipment to the nation-wide telephone network". See FCC, *A Glossary of Telecommunications Terms* (1998), available at http://www.fcc.gov/Consumers/glossary.html.
[39] Brooks (1975), p. 114.

monopoly.[40] The public soon came to view AT&T as something of a corporate bully.[41] AT&T's actions of hostile acquisitions and its unyielding refusal to grant interconnection to independents prompted the government to take action and consider establishing some control over the industry.[42]

In 1913, the Wilson Administration, under pressure from independent companies whose services were in decline through Vail's aggressive policies, proposed antitrust action (and even public ownership) in telephony. Vail, however, cleverly turned the company's policy around. This leads us to the fourth main strategy in Vail's plan of achieving his vision of a "one system, one policy, universal service" telephone industry for the US: Vail's cooperation with the government and his effective use of the government's own actions as a means to creating a monopoly for AT&T. AT&T settled its first anti-trust suit in the form of a letter, known as the Kingsbury Commitment (after AT&T vice-president Nathan Kingsbury). The Commitment was a promise to relinquish control of Western Union Telegraph Company, to allow independent companies

[40] Today, interconnection is one of the key aspects of promoting competition in the telecommunications sector. It is so vital that the concepts of transparent and non-discriminatory terms of interconnection are central to the telecommunications policies of all developed countries. Moreover, these concepts have found their way into international commitments as one of the provisions in the WTO Reference Paper on pro-competitive principles. From historical experience, the US was keen to include a provision on interconnection in the Reference Paper: the US knew from history that interconnection is very important to market access and competition in telecommunications. Interconnection was also the focal argument in the US case against Mexico in the WTO panel's first case on telecommunications services. See Chapter 4 on the Reference Paper and the *Mexico-Telecommunications* case.

[41] Dick Olufs, *The Making of Telecommunications Policy* (1999), p.31.

[42] Up to this stage, the federal government did not feature in the development of the telephone industry. Regulation was a matter for states. The beginning of federal regulation of telecommunications finds its root in the Mann-Elkins Act of 1910, which extended the power of the Interstate Commerce Commission (ICC), originally established in 1887 to regulate the railroad industry, to include overseeing communications. The ICC was given jurisdiction over interstate rates charged by telegraph, telephone and cable companies. However, due to its preoccupation with railroad problems, the ICC exercised very little regulatory oversight of the telephone industry beyond instituting an accounting system for the industry. For the most part, there was little regulation of the telephone until the establishment of the Federal Communications Commission in 1934.

limited interconnection to AT&T's long-distance network and to acquire independents only with the approval of the regulators. In exchange, the Justice Department relaxed its pressure on AT&T.

The Kingsbury Commitment was the key turning point in the evolution of US telecommunications from competition to monopoly. It had a number of far-reaching consequences for the US telecommunications industry. First, by allowing independents to interconnect to the Bell system the government effectively reduced competition between Bell and the independents and ironically allowed AT&T to gain greater control over the industry. Although interconnection reduced Bell's ability to drive its competitors out of business, it also eliminated the independents' incentives to establish a competitive long-distance system. The Kingsbury Commitment, although thought by the government to be pro-competitive, thus marked the re-emergence of Bell dominance and the beginning of the end for telephone competition.[43]

Second, the Commitment actually contained a built-in incentive for "monopoly-swapping" rather than continued competition.[44] This was due to the manner in which regulators interpreted the agreement not to restrict AT&T from acquiring any new telephone systems, but only to require that an equal number be sold to an independent buyer for each system AT&T purchased. Hence, as Brock noted:

> This provision allowed Bell and the independents to exchange telephones in order to give each other geographical monopolies. So long as only one company served a given geographical area there was little reason to expect price competition to take place.[45]

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[43] Horwitz (1989), p. 101; Thierer (1994).
[44] Thierer (1994).
[45] G.W. Brock (1981), p. 156.

Third, the Kingsbury Commitment meant the recognition by law of the 1879 division of fields between voice and record/data communications.[46] The result was that the markets were carefully carved up to create a monopoly for telegraph, another one for each of the established local telephone exchanges and another for AT&T's long-distance operations, thus creating a sort of "competitive apartheid".[47] Bell might not own everything, but some monopolist or other would dominate each discrete market.

Consequently, the Kingsbury Commitment not only made it possible for AT&T to avoid the threat of nationalization or "postalization",[48] it secured AT&T's position as monopoly provider. After 1913, the violence of competition had abated and most of the growth occurred in the Bell system.[49] On the whole, the Kingsbury Commitment, with a helping hand from an unaware government, thus paved the way towards the idea that the telephone industry was a natural monopoly.[50]

Meanwhile, Vail worked closely with regulators to legitimize this idea of a natural monopoly.[51] AT&T would receive antitrust exemption to operate a vertically integrated telephone system and would receive a fair

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[46] The 1879 agreement between Western Union and the Bell Company effectively constructed a division in the electrical communications industry by stipulating that the company providing one type of communications services – telegraph – was not to enter into the business of the other type of communications services – telephones, and vice versa.
[47] M. Kellogg, J. Thorne and P. Huber, *Federal Telecommunications Law* (1992), p. 16-17.
[48] "Postalization" involved the telephone system being taken over by the Post Office Department and operated together with the postal service. In 1913, the new U.S. postmaster general advocated this. Cf. In the UK, the telegraph was nationalized as early as 1868 and in the 1890s, the trunk telephone network followed. In 1912, the UK adopted blanket postalization of the telephones. Most of Western Europe had also "postalized" their telephones. See Horwitz (1989), pp. 100-110; Brooks (1975), pp. 148-149.
[49] Brooks, *Telephone* (1975), p. 260-1.
[50] Olufs (1999), p. 33.
[51] See Richard Vietor (1994), p. 172; Olufs (1999), p. 33; R. Garnet (1985), p. 130.

and reasonable return on its investments. In turn it would provide a technically advanced, reliable system available to as many people as possible - what is called "universal service". The term itself was coined by Vail.[52] At the same time, Vail began to speak favourably of government regulation, arguing that such policy could be beneficial and a stabilizing force for telephony.[53] As Olufs observed:

> A new assumption had entered the regulatory arena: a regulated monopoly, working closely with government officials, could effectively deliver a national service.[54]

Vail's visionary policies and clever business tactics contributed to the monopolistic dominance of AT&T in telecommunications - a dominance which shaped public and official opinion into believing that the telephone industry was a natural monopoly which would best deliver in the public interest through regulation.[55]

II. A New Era of Government Regulation: the Communications Act of 1934

The idea of the telephone as a natural monopoly that could deliver services in the public interest was the fundamental rationale upon which the

[52] According to Duesterberg and Gordon, the current understanding of the term "universal service" dates only to the late 1960s and early 1970s and the best historian of this idea is Milton Mueller. The idea of "universal service" used by Vail was an inventive means of eliminating competition in telephony and thereby making AT&T the monopoly service provider. See Thomas Duesterberg and Kenneth Gordon, *Competition and Deregulation in Telecommunications: The Case for a New Paradigm* (1997), p. 48; and Milton Mueller, *Universal Service: Competition, Interconnection and Monopoly in the Making of the American Telephone System* (1997).

[53] Horwitz (1989), p. 99; R. Garnet (1985), p. 130.

[54] Olufs (1999), p. 33.

[55] One commentator noted: "Legislators began referring to competition in the same term as Vail – 'duplicative,' 'destructive,' and 'wasteful'." Thierer (1994).

passing of the 1934 Communications Act was based.[56] This important Act brought the telecommunications industry under one regulatory agency, whereby the systematic and structured federal control of this industry began. It was the first significant active involvement of Congress in telecommunications regulation. The second major intervention would be sixty years later with the enactment of the Telecommunications Act of 1996, a measure with a totally different purpose.[57]

An examination of the theory of natural monopoly is undertaken in this section to determine why the US government chose, in 1934, to regulate the telecommunications industry instead of leaving it to market forces and allowing it to operate under competition.[58] The section then discusses the US independent telecommunications regulator, the Federal Communications Commission (FCC), created by the 1934 Act and the regulatory policies that governed the telecommunications sector during the monopoly era.

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[56] The constitutional basis of economic regulation and the public interest standard could be traced to the landmark case of *Munn v. Illinois* in 1877, where the Supreme Court ruled that the states had the right to regulate business. The opinion of the majority stated: "When ... one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good." *Munn v. Illinois* (94 U.S. 113 (1877) at 126). The idea was thus adopted to the telephone, which had come to be viewed by the government as an infrastructure providing public services and therefore should be regulated in the public interest.

[57] See Section V below.

[58] The natural monopoly argument for regulation is perhaps the most important and widely accepted argument for economic regulation. It has provided the rationale for regulating not only telecommunications service, but also for electric-power and natural gas distribution, water supply, and some common carrier transportation service. Viscusi, Vernon and Harrington, *Economics of Regulation and Anti-Trust* (1995), p. 351.

1. *Regulation of the Telecoms 'Natural' Monopoly*

The idea began to emerge that competition in the telecommunications industry was wasteful and expensive. The cost of building one telephone connection required poles being erected and wires strung from pole to pole to connect every telephone customer. Many telephone companies emerged after Bell's patents ended in 1894 to provide competing services. The problem, as seen above, was that the different networks were not interconnected. The result was that businesses often had to subscribe to more than one service provider. The government, with the influence of AT&T, came to see this as wasteful and inefficient. The government wanted one system to provide telephone service, by then an important factor in the US economy, to the population across the country. The government came to believe that every US person was entitled to telephone service – embracing Vail's vision of universal service. The justification for regulation was the belief that the telephone industry was a natural monopoly.

(a) The Theory of Natural Monopoly

In the nineteenth century, economists such as Augustin Cournot and Jules Dupuit depicted the monopoly as a single firm that could charge prices free of market dictation.[59] A monopoly is simply a market in which there is only one supplier, and is characterized by three features: the firm is motivated by profits, it stands alone because barriers to entry prevent new firms from entering the industry, and the actions of the monopolist itself affect the market price of its output.[60] A monopoly is held to be inefficient and in the long term there is no tendency for costs to be at their lowest possible level, because the pressure from more efficient, incoming competitors does not exist.

John Stuart Mill in 1848 made a critical distinction between what have come to be labelled as a "natural" monopoly and a "contrived" monopoly, although he did not explicitly use the terms "natural" or "contrived".[61] The natural monopoly was not defined in terms of the actual number of firms in the market at a given time or in terms of its ability to manipulate price, but instead in terms of the relative *efficiency* of serving the market with a single firm.[62] The concept of natural monopoly soon began to be identified with the notion of economies of scale.[63] An industry is a natural monopoly "if the production of a particular good or service by a single firm minimizes cost".[64]

The issue is how society can benefit from least-cost production - which obviously requires single-firm production - without suffering from monopoly pricing. The problem is that a single firm would eventually win

59 See A. Cournot (1838) and (1960); J. Dupuit (1844) and in K. Arrow and T. Scitovshky, eds. (1969); Kaserman and Mayo, "The Economics of Regulation: Theory and Policy in the Postdivestiture Telecommunications Industry", in *Public Policy Toward Corporations* (Heggestad and Smith, eds.) (1988), p. 142.

60 Bannock, Baxter and Davis, *The Penguin Dictionary of Economics* (1998, 6th edition).

61 J.S. Mill, *Principles of Political Economy* (1848, 1st edition).

62 Kaserman and Mayo (1988), p. 142.

63 Economies of scale are factors which cause the average cost of producing a commodity to fall as output of the commodity rises. Bannock, *Penguin Dictionary of Economics* (1998).

64 Viscusi, Vernon and Harrington (1995), p. 351.

the entire market by continuing to expand output and lowering its costs. Having won the market, it could then set the monopoly price. Government regulators have therefore justified the need for direct regulation of an industry that is thought to be a natural monopoly, as in the telecommunications industry.

The theory of natural monopoly has been extensively revised, from the work of Bonbright[65] in 1961 through to the more recent work of Baumol, Panzar, and Willig[66] in 1982. The revised theory reveals that economies of scale can no longer be relied upon as the exclusive determinant of whether or not an industry is a natural monopoly. Instead, a natural monopoly is defined in terms of the 'subadditivity' of the cost function: when "the production of all combinations of outputs [in an industry] is accomplished at least cost by a single firm."[67] In other words, it is most cost-efficient for one firm to produce *all* levels of output, rather than for one firm to produce a *portion* of the output and another second firm to produce the rest of the total output of an industry. Subaddivity depends on both economies of scale and economies of scope.[68] If both exist, then subadditivity will likely exist. This revised definition of natural monopoly consequently triggers the need to question the validity of the beliefs, held so strongly in the first half of the twentieth century, that certain industries, like telecommunications or electricity, were natural monopolies and therefore required regulation.

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[65] Bonbright, Principles of Public Utility Rates (1961).
[66] Baumol, Panzar and Willig, *Contestable Markets and the Theory of Industry Structure* (1982).
[67] Viscusi, Vernon and Harrington (1995), p. 257.
[68] Economies of scope are factors which make it cheaper to have one firm produce a range of related products than to have different firms produce each of the individual products on their own. See *supra* n. 63 for the definition of economies of scale. Bannock, *Penguin Dictionary of Economics* (1998).

There have been further advances in the theory of natural monopoly involving "potential entry" into the industry. Kaserman and Mayo summarized this as follows:

> When (1) potential entrants can serve the same market demand and have access to the same general technology and inputs as incumbent firms, (2) potential entrants do not face entry costs greater than those faced by current incumbent firms, and (3) potential entrants evaluate the profitability of entry at the incumbents' pre-entry prices, then it can be shown that industry pricing, regardless of market structure, will remain efficient due to the threat of entry.[69]

What this means is that when these three conditions are satisfied, an industry thought to be a natural monopoly could actually produce outputs with efficiency results approximating that of a competitive market. If this is the case then regulation is consequently unnecessary since there would not be a threat of the incumbent firm charging monopoly price.[70] Once there is potential for competition in a market, the break down of a system of regulation of a natural monopoly becomes possible if not inevitable. This recent development to the theory of natural monopoly would explain the weakening of the natural monopoly rationale of telecommunications regulatory policies in the late 1960s and would pressure the FCC to allow new entrants into the industry, for example MCI, AT&T's rival in private line services.[71]

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[69] Kaserman and Mayo (1988), p. 144.

[70] The object of economic regulation is to substitute for competition in order to discipline natural monopolies. If competitive characteristics exist in a market, then logically there is no need for regulation.

[71] See Section III.2(c) below.

(b) Was AT&T a 'natural' monopoly or a 'created' monopoly?

It appeared that the long-distance market was a natural monopoly – but this appearance was created by AT&T's dominance and the creation of this dominance was in turn helped on by government actions. But was the telephone industry, in actuality, a "natural" monopoly?[72]

There are a number of factors that explain why the telephone industry appeared at the time to be a natural monopoly. First, until the 1940s, the best available production technology was the open-wire line system,[73] which involved stringing wires between poles in order to send messages across geographical regions. Because of the very high fixed costs of such a system and the relatively low marginal cost of adding another customer, economies of scale were believed to exist.[74]

In the 1930s, AT&T developed coaxial cable, which replaced the open wire line system as the best available technology. Coaxial cable is able simultaneously to carry a much greater number of long-distance communications lines. However, while a technological improvement, coaxial cable also entails sufficiently large fixed costs that a natural monopoly existed even for the largest intercity telecommunication routes. Thus, cost efficiency demanded single-firm production, and AT&T was the government's chosen monopoly supplier.

[72] It must be noted that "the problem of determining empirically whether a monopoly is justified by cost conditions - whether a natural monopoly exists - is difficult; attempting to do so by inference from the actions and cost data of a regulated utility is nearly impossible". Waverman, "The Regulation of Intercity Telecommunications", in *Promoting Competition in Regulated Markets* (Phillips, ed.) (1975), p. 204.

[73] The open-wire line system had a one-call-at-a-time capacity. This was how the telephone system (network) first started off. See AT&T's history at http://www.att.com/history.

[74] See the theory of natural monopoly above.

Second, AT&T had the huge advantage of operating a recognized company and providing established services. The company held patents that were especially crucial in large systems. AT&T had already established rights of way for its wires. Potential competitors would have to cope with state and local rules barring competition and negotiate connection with the nearby AT&T facilities.[75] The FCC recognized the fact that one corporation dominated the telephone industry, that the Bell System had consistently pursued the policy of obtaining control of a nation-wide unified telephone system and that it had so far been successful in the elimination of effective competition.[76] At the end of 1936 there were 18,516,211 telephone stations in the United States, of which 14,827,755 were Bell-owned.[77] In its first report, based on the first comprehensive investigation of the telephone industry, the FCC affirmed the telephone industry to be a natural monopoly:

> Attempts at this late date to develop a strong, independent telephone system to compete with the Bell System would be futile. Protection of the rate-paying public by means of effective competition is now, and for a number of years has been impossible.[78]

Until the late 1930s therefore, long-distance telecommunications could be described as a natural monopoly.

However, on closer examination, the telephone industry might not, of its own constitution, be a natural monopoly but was moulded into one by certain government policies (both accidental and intentional), tactical moves by AT&T and the First World War.[79] A number of government

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[75] Brock (1981), p. 177.
[76] FCC, *Investigation of the Telephone Industry in the United States* (1939), p. 578.
[77] *Ibid.*, p.579.
[78] *Ibid.*
[79] See Thierer (1994).

actions contributed to the formation of the natural monopoly of the telephone industry, but we will concentrate on three: the Kingsbury Commitment, the abandonment of postalization and the Willis-Graham Act. The effects of the Kingsbury Commitment have already been discussed above. The Kingsbury Commitment, as we have seen, also prevented the postalization of AT&T. Nonetheless, during World War I, the entire telecommunications industry was nationalized (postalized) for a year (from 1 August 1918 to 1 August 1919) due to national security reasons. This period proved beneficial to AT&T as the government signed a contract that was highly favourable to AT&T.[80]

In addition, AT&T applied for an increase in telephone rates. To meet its obligations to AT&T and to expand its wartime service, the Postmaster General ordered a 20 per cent increase in long-distance rates in December 1918. At the end of the war, of the approximately $ 50 million in rate increases approved by the postmaster general during nationalization, $ 42 million went to AT&T.[81] Local authorities resisted the rate hikes but the Supreme Court ruled that the Postmaster General had the power to set telephone rates. This period of nationalization convinced Vail that government oversight could play a strategic role in the company's vision of "one system, one policy, universal service".[82]

The public furore over the rate increases eliminated any prospects for continued government ownership of telephony, and the system was returned to private ownership in 1919. Thus, the idea of nationalizing the US telecommunications industry was abandoned, and unlike Europe and

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[80] Noobar Danielian, *AT&T: The Story of Industrial Conquest* (1939), p. 252.
[81] Thierer (1994).
[82] Danielian (1939), p. 248; G. Oslin, *The Story of Telecommunications* (1992).

most of the world, operation of the industry in the US remained in private hands. The abandonment of nationalization meant, however, that the US telephone industry was allowed to continue as a monopoly, dominated by AT&T.

Rate regulation of interstate services during WWI had important effects on telecommunications policy and the evolution of the industry into a natural monopoly.[83] The view emerged that a single monopolistic provider controlled through rate regulation could effectively achieve social policy objectives.[84] State regulators began following federal action in regulating rates. Business and urban users were charged higher and above-cost rates than rural customers to raise revenue to extend services to distant locations and to artificially suppress rural rates. Thus, cross-subsidization of the telecommunications industry began.[85] Furthermore, by averaging rates geographically to subsidize rural telephony, policymakers and regulators discouraged local telephone competition.[86] Few firms will seek to enter a market and offer service where it is difficult, if not impossible, to undercut the subsidized service of the incumbent carrier. The combination of state and federal regulation thus stabilized and ended the rate wars that had occurred during the early period of competition (1894-1912).[87] Regulation had the effect of increasing the difficulty of new entry, and thus helped AT&T achieve its monopolistic hold and put in place the policy of "universal service".[88]

[83] Thierer (1994).
[84] Thierer (1994); Horwitz (1989) pp. 103, 132-133; R. Garnet (1985), p. 152.
[85] Hyman, Toole and Avellis (1987), p. 81.
[86] Thierer (1994).
[87] Brock (1981), pp. 159-161.
[88] *Ibid.*

Another government action which could have contributed to the monopoly of the telephone industry was the enactment of the Willis-Graham Act in 1921.[89] This gave the Interstate Commerce Commission (ICC) powers to approve or disapprove consolidations and mergers of telegraph and telephone companies. Strong support for the Act came from competing independent telephone companies whose financial fortunes had declined and wished to be bought out by Bell.[90] By this time, the prevailing view was that telephony constituted a natural monopoly, and that AT&T should be allowed to take over the failing independents without the risk of anti-trust action. The Willis-Graham Act thus provided anti-trust immunity to AT&T,[91] so that AT&T was authorized to operate as a monopoly.

Another factor that paved the way for federal regulation of the telecommunications industry involved rate-making. The problem involved the competing jurisdictions between state and federal bodies. State commissions wanted to control the rates AT&T charged for long-distance (interstate) services and the high license fee AT&T charged its local operating companies for services provided to them by the AT&T parent. By charging local operators a license fee AT&T was able to shift costs and services between jurisdictions and transfer revenue out of the local companies and into the parent company. The efforts of state regulatory commissions to alter this balance were, however, rebuffed by the courts.[92]

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[89] Willis-Graham Act, 42 Stat. 27, June 10, 1921; Horwitz (1989), p. 102.
[90] G. Hamilton Loeb (1978), pp. 13-14; Bornholz and Evans (1983), p. 33; Thierer (1994).
[91] Horwitz (1989), p. 102.
[92] In 1923, the Supreme Court refused to permit the Public Service Commission of Missouri to disallow certain payments by the local Bell company to AT&T. *Southwestern Bell Telephone Company* v. *Public Service Commission of Missouri*, 262 U.S. 276 (1923).

However, in 1930, during the Great Depression, the court, in a change of attitude towards regulation, ruled that AT&T charges to the local operating companies must be justified in terms of costs to AT&T of performing the services.[93] The court ruled that the local telephone network was used jointly for local and long-distance service and effectively mandated a "station-to-station" theory of separations, whereby long-distance would have to pay some percentage of the joint costs of the local exchange. Thus, the decision provided the legal foundation for the practice of separations, which has played a crucial role in later policy issues in communications.[94] The court nonetheless also clearly ruled that interstate service rates were beyond the authority of the state commission. The need for a federal body with the appropriate jurisdiction to deal with interstate services rates thus provided one of the reasons for the creation of the FCC.

There was no doubt that a monopoly existed in the telephone industry and certain issues, for instance the rate problem between state and federal jurisdictions, convinced those in government that some form of systematic federal regulation of the industry was needed. However, the arguments explored above seem to suggest that the telephone industry was not a natural monopoly *per se,* but that AT&T was allowed to develop into a monopoly through government actions and other factors, such as AT&T's aggressive business tactics, discussed above.[95]

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[93] *Smith* v. *Illinois Bell Telephone Company* 282 U.S. 133 (1930).

[94] "Separations" was the procedure by which regulators divided assets and costs between the state and federal jurisdictions. The separations policy is discussed in section II.4(b) below.

[95] See Section I.4.

By 1932, AT&T's market share reached 79 per cent, with control of major local operating companies, the major equipment manufacturing apparatus and the long-distance network.[96] The percentage of all telephones operated by independent telephone companies declined from 36 per cent to 21 per cent from 1921 to 1934.[97] By 1934, virtually all telephones were connected with the Bell System and there was no direct competition to it.[98] Given this situation, the hope was to legitimize the concept that an efficient telephone industry would only be able to provide quality service necessary for an advancing nation like the United States through one firm because that industry was a "natural" monopoly.

As stated earlier, a natural monopoly runs the risk of becoming inefficient, and alternative policy solutions are therefore adopted in an attempt to avoid or cure inefficiencies. Possible alternatives include "doing nothing", competition among bidders for the right to the monopoly franchise, state ownership, and regulation.[99] With the enactment of the 1934 Communications Act, the US Congress chose to regulate the telephone industry. The FCC set out the rationale for the adoption of the first legislation on telecommunications regulation as follows:

> The necessary attributes of so-called natural monopoly which ordinarily attend efficient and economical telephone service; the intimate relation of such service to social well-being, both local and national; the nature of telephone service as a fundamental necessity of modern living; and the public interest in the progressive development of increasingly effective and economical communication facilities are all factors which disclose the underlying character of this business as an essential public utility - entitled in the interest of its patrons to reasonable protection from wasteful competition, and entitled to make reasonable charges for its service, but

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[96] Horwitz (1989), p. 102.
[97] Bornholz and Evans, "The Early History of Competition in the Telephone Industry", in *Breaking Up Bell: Essays on Industrial Organization and Regulation* (David Evans, ed.) (1983), pp. 7-40 at 14; and FCC, *Telephone Investigation* (1939), pp. 139-143.
[98] *Ibid.*
[99] Viscusi (1995), p.358.

subject to public scrutiny, regulation, and control, to the end that adequate service, equal treatment, and reasonable and nondiscriminatory rates may be assured to all who may apply. The importance of the telephone industry and the magnitude of telephone operations demand actual and not nominal regulation.[100]

2. The Communications Act of 1934

Regulation is influenced by the politics, economic policies, institutional roles, and technological developments of each era. During the Presidency of Franklin D. Roosevelt, a new era of governmental regulation emerged. Roosevelt took over the presidency after the Great Depression, which from 1929 to 1933 reduced the national economy to two-thirds, and trade to half the size it had been four years earlier.[101] One in four workers was unemployed, and millions of Americans were poverty-stricken.[102] The Roosevelt administration adopted an activist federal role in rebuilding the economy through efficiency, clear lines of authority and accomplishment of organizational goals.[103] President Roosevelt and his advisors sought to create an organized system of regulation, including the grouping of like activities under single agencies.[104] The Roosevelt administration justified this reorganization as a means of bringing about greater efficiency and effectiveness of government.

In the field of telecommunications, the President recommended that Congress create a new agency that would bring this industry comprehensively under federal regulation. He stated:

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[100] FCC, *Investigation of the Telephone Industry* (1939), p. 597.
[101] The 1930s also witnessed the collapse of the multilateral trade and payments system which had emerged in the late nineteenth century. A. Kenwood and A. Lougheed, *The Growth of the International Economy: 1820-1990* (1992), p. 235.
[102] William Nester, *A Short History of American Industrial Policies* (1998), p. 164.
[103] Olufs (1999), p. 35.
[104] *Ibid.*

I have long felt that for the sake of clarity and effectiveness the relationship of the Federal Government to certain services known as utilities should be divided into three fields: Transportation, power, and communications. The problems of transportation are vested in the Interstate Commerce Commission, and the problems of power [...] in the Federal Power Commission.

In the field of communications, however, there is today no single Government agency charged with broad authority.

I recommend that Congress create a new agency to be known as the Federal Communications Commission, such agency to be vested with the authority now lying in the Federal Radio Commission and with such authorities over communications as now lies with the Interstate Commerce Commission - the services affected to be all those which rely on wires, cables, or radio as a medium of transmission.[105]

The President's message initiated debates and hearings in both Houses, and Congress passed on 19 June the Communications Act of 1934. The Act created the regulatory agency that is the Federal Communications Commission (FCC) and brought about systematic federal regulation of telecommunications.

3. *Creation of the FCC: A 'Super' Regulator*

As we have seen, there was no effective regulation of AT&T, apart from the Kingsbury Commitment, before the 1934 Act. AT&T obtained the benefit of "a *de facto* sanctioned monopoly without the *quid pro quo* of regulatory oversight."[106] However, the 1934 Act, an event that would condition the US telecommunications industry for the next sixty years, changed that. There emerged a federal authority, the FCC, to regulate the telecommunications monopoly provider AT&T, and which continues to

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105 S.doc 144, 73d Congress, 2d Session.
106 Horwitz (1989), p. 104.

regulate the telecommunications industry today.[107] The US has thus had fifty years of experience in monitoring the telecommunications industry through an independent regulator prior to other countries – the UK, for instance, only established its independent regulator, Oftel, in 1984. The US is therefore an authority in utilizing the independent regulator to oversee the telecommunications industry; at first, to regulate a monopoly but now to liberalize and introduce competition into the telecommunications sector.

(a) Structure of the FCC

The FCC is an independent regulatory agency, independent of the Executive Branch and directly responsible to Congress. It is currently composed of five Commissioners,[108] each of whom is appointed by the President, subject to the consent of the Senate.[109] Each commissioner serves five-year terms and can be re-appointed once only.[110] The President designates one of the five commissioners as chairman.[111] As chief executive officer of the Commission, it is the Chairman's duty to preside at all meetings and sessions of the FCC, to represent the Commission in all matters relating to legislation and reports and in conferences or communications with other government bodies, and to coordinate and organize the work of the Commission in a manner that promotes prompt

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107 Today, the power, functions and authority of the FCC are derived from the Communications Act of 1934 as amended by the Telecommunications Act of 1996.
108 The FCC originally had seven Commissioners, which were reduced to five in 1983.
109 Section 4(a) of the 1934 Act as amended, 47 U.S.C. 154.
110 Section 4(c) of the 1934 Act as amended.
111 Section 4(a) of the 1934 Act as amended.

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and efficient disposition of all matters within the jurisdiction of the FCC.[112] The Commissioners are responsible for formulating policy initiatives, implementing new legislation and adopting agency rules and regulations. For day-to-day running, however, the Commissioners delegate responsibilities to its bureaus and offices.[113]

(b) Powers and responsibilities of the FCC

The FCC's mandate was broad and general. Its broadest obligation was "to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges".[114] This was the mandate established in 1934 by the Communications Act and remains so today. As explained above, the FCC was created to regulate the telephone industry, but was also responsible for

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[112] Section 5(a) of the 1934 Act as amended, 47 U.S.C. 155.

[113] Currently there are six bureaus and eleven staff offices. The six bureaus are Consumer and Governmental Affairs, Wireline Competition, Enforcement, Wireless Telecommunications, Media and International. The eleven offices are Office of the Administrative Law Judges, Communications Business Opportunities, Engineering and Technology, General Counsel, Inspector General, Legislative Affairs, Managing Director, Media Relations, Secretary, Strategic Planning and Policy Analysis, and Workplace Diversity.

[114] Section 1 Communications Act 1934. The Act thus embraced the concept of "universal service".

administering the broadcasting industry and allocating the electromagnetic spectrum.[115]

The FCC, often described as a 'super' regulator, has wide jurisdiction, covering numerous sectors of communications, including fixed, mobile, satellite and broadcasting, as well as licensing and enforcement. It regulates all interstate and foreign communications issues, including content regulation.[116] It also has jurisdiction over tariffs, mergers and acquisitions in the telecommunications and broadcasting industries. The FCC's jurisdiction covers both service providers and facilities-based operators.

Section 4(i) embodies the Commission's broad powers:

> The Commission may perform *any and all acts*, make such rules and regulations, and issue such orders, not inconsistent with this Act, *as may be necessary in the execution of its functions.*[117]

This broad power to "perform any and all acts ... as may be necessary in the execution of its functions" and the FCC's functions being to "execute and enforce the provisions of this Act"[118] endorses the FCC with the ability to wield significant policy-making authority.[119]

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[115] A different situation applied to the former UK regulator, Oftel (Office of Telecommunications), whose regulatory responsibilities did not include regulating broadcasting. There were separate regulators each for broadcast in radio and broadcast through television. Today, a new regulator, Ofcom (Office of Communications), which came into operation on 29 December 2003, is closer in role and power to the FCC. Ofcom is the UK's independent regulator of communications with responsibilities in broadcasting (radio and television), telecommunications and wireless communications. It is also a competition authority for the UK's communications industries. Ofcom has replaced and inherited the duties of five former regulators: Oftel, the Broadcasting Standards Commission, the Independent Television Commission, the Radio Authority, and the Radiocommunications Agency.

[116] Following the passage of the 1996 Telecommunications Act, the FCC also regulates certain intrastate issues.

[117] Section 4(i) Communications Act 1934 as amended, 47 U.S.C. 154. Italic emphasis added.

[118] Section 1, 1934 Act as amended, 47 U.S.C. 151.

[119] Karen Lee and Jamison Prime, "Telecommunications in the United States", in *Telecommunications Law* (Walden and Angel, eds.) (2001), p. 325.

Although the FCC has wide jurisdiction in the regulation of all interstate and foreign communications by wire or radio, it was expressly forbidden from regulating intrastate communications services.[120] Subsequent court decisions, however, have limited this exclusion to those matters that are "... separable from and do not substantially affect the conduct or development of interstate communications."[121] As a result the FCC has been able to assert regulatory authority over the measurement and division of the rate base, inside wiring, and terminal equipment.

The 1934 Act also entrusted the Commission with broad and powerful enforcement mechanisms. The FCC may enforce the provisions of the 1934 Act directly, or request the US federal district courts to initiate enforcement proceedings.[122] The Commission has broad authority to ensure compliance with federal telecommunications law, subject to the requirement that any action taken is "consistent with the public interest, convenience and necessity".[123] These broad enforcement powers allow it to ensure the implementation of its telecommunications policies, enabling it to have a direct hand in shaping the telecommunications industry.

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[120] Except as provided in sections 223 through 227 inclusive (which include provisions on obscene telephone calls, on regulation of pole attachments, telephone services for the hearing and speech impaired, telephone operator services, and on restrictions to telephone equipment), and section 332 (on mobile services), and subject to the provisions of section 301 (license for radio communications) and Title VI (cable services). Section 2 Communications Act 1934. Regulatory matters that fall under state jurisdiction are regulated by the state public utility commissions.

[121] *North Carolina Utility Commission* v. *FCC*, 537 F.2d 793 (4th Cir. 1976).

[122] See Section 401 Communications Act 1934.

[123] These principles appear in a number of provisions in the 1934 Act as amended by the 1996 Telecommunications Act. See Section 706(a) of the 1996 Telecommunications Act on advanced telecommunications services; Section 214(a) Communications Act 1934 has '... public convenience and necessity require ...'; and Sections 214(c) and (d) 1934 Act. These principles also apply to state commissions: see Sections 214(e)(2) and 310(d) 1934 Act.

4. *FCC Policies during the Monopoly Years*

Between the 1930s and the late 1960s the FCC (or the individual state public utility commissions) regulated virtually every aspect of the telecommunications industry. During these years, the policy of the Commission was to regulate AT&T's monopoly in the public interest through price and entry mechanisms. As explained above, the government viewed the US telephone industry as a natural monopoly, and it followed that the US public would benefit most from having only one major company provide the country's telephone services. Thus the irony that the FCC – created to monitor the telephone industry that was dominated by this single firm – ensured that AT&T remained in this dominant position.[124] There were two main causes for this dominance: FCC's policies of regulating AT&T as a natural monopoly, and the fact that regulating the telecommunications industry was an enormous and difficult task.

As in any industry, developments in technology could change the nature of the industry in relation to the market. This was particularly so in the telecommunications industry, where the introduction of microwave technology in the 1940s was responsible for increased demand for competition in the industry. The regulators, however, failed to realize that an industry that no longer qualified as a natural monopoly did not need to be regulated as one. The FCC, however, with its inferior resources of man-

[124] See Olufs (1999), pp. 36-37.

power and capital was not always capable of keeping up with the fast-growing telecommunications industry.

The policies that shaped the FCC's regulation during the monopolistic years of the telecommunications industry could be grouped into three broad categories: rate-of-return regulation, the separations system of rate-making and entry regulation.[125]

(a) Rate-of-return Regulation

Regulation of a monopoly entails the direct involvement of the independent regulator in rates charged by the regulated provider. In fact, the basic working of the regulatory process consists of rate regulation.[126] The FCC directly regulated AT&T's rates until the 1990s. The aim is to control the monopoly firm's pricing so that it does not abuse its monopoly position and obtain super-normal profits through pricing that might be very high in relation to costs. The object of rate regulation is to ensure that prices are approximate to those in a competitive environment, where it is assumed that competition will ensure that there should not be excess profit.

In its rate regulation of the telecommunications industry, the FCC adopted the rate-of-return model of regulation. Rate-of-return regulation allows the firm to earn no more than its allowable costs, where costs include a pre-determined maximum rate of return to be earned by the shareholders who have invested in the equity of the firm. In essence, rate-

125 Rate-of-return regulation and the separations system are regulation through pricing policies, while entry regulation constitutes an entry-type policy.
126 It has been pointed out that rate regulation is only appropriate where one or more firms can exercize market power by raising prices above competitive levels. It thus follows that if there are no longer any firms that can exercise market power, regulation should be removed. Naftel and Spiwak (2000), p. 67.

of-return regulation is a cost-plus contract between the utility and the state. A ceiling is placed on the profits that a company could keep from its regulated business, based on the company's required rate of return on capital.

Because the core of the monopoly problem, as traditionally conceived, is monopoly prices and profits, the determination of the overall revenue requirements that just cover the test-year[127] costs of the regulated firm is the heart of the regulatory process. Thus, the problem with regulation of a monopoly consists of calculating rates, which is very complex.[128] The main problem was that the FCC did not always have the man power or all the information necessary to calculate the correct rate base. Thus, it often turned out that the FCC left AT&T to determine its own rates which were then approved by the FCC on the assumption that AT&T 'knew best'. Moreover, this enabled AT&T to control the process, because it alone possessed the relevant information. The supply of information available is a particularly important constraint on regulatory decision making. This issue of information costs was one of the main arguments used to highlight the inefficient workings of the FCC and its apparent weakness in keeping up with AT&T. The argument was thus rate-setting is best left to market forces.[129]

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[127] A test-year is ordinarily the most recent typical year of operations for which complete data are available.

[128] It is difficult to accurately determine all costs: the cost of equity capital, the valuation of rate base, and often costs and valuation are not continuously updated. See Posner (1969), pp. 592-597.

[129] S. Lundstedt and M. Spicer, "Latent Policy and the Federal Communications Commission", in *Telecommunications, Values, and the Public Interest* (S. Lundstedt, ed.) (1990), p. 293-4.

Meanwhile, studies on the rate-of-return model of regulation were conducted and concluded that it was fundamentally flawed.[130] In the 1960s Averch and Johnson demonstrated that under fairly general conditions rate-of-return regulation will provide an incentive for regulated firms to employ an inefficient input mix.[131] They demonstrated that a firm regulated with respect to the maximum allowable rate of return on equity had an incentive to be inefficient in both production – to substitute capital for labour – and pricing. These firms also had an incentive to misprice services.

Rate-of-return regulation also creates problems of incentives which are not compatible with minimization of costs or maximization of social welfare.[132] In addition, rate-of-return regulation results in the regulated firm's diversion from ensuring customer satisfaction to playing the regulatory "game" – that is, using the regulatory process to the firm's advantage.[133] The problem is that it is difficult to determine the basis on which rates are set under the rate-of-return regulation, and the regulated firm must thus resort to manoeuvres that would keep it ahead of the game.

Most industry participants, academics and a growing number of regulators today consider the rate-of-return regulation for telecommunications services to be "flawed, expensive and inefficient".[134] The FCC began moving away from rate-of-return regulation in the early

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130 See H.A. Averch and L.L. Johnson, "Behaviour of the firm under regulatory constraint", 52 *American Economic Review* (1962), pp. 1052-69; H. Leibenstein (1966); L.J. White (1972); J.W. Mayo (1984).
131 Averch and Johnson (1962).
132 Crandall and Waverman (1995), p. 106.
133 Crandall and Waverman (1995), p. 99.
134 Crandall and Waverman (1995), p. 41.

1980s towards cost-based regulation. Economists consider cost-based regulation to be a more efficient way of regulating telecommunications towards competition. This choice of regulatory mechanism has been incorporated into the 1996 Telecommunications Act and the WTO Reference Paper.[135]

(b) Separations System

The difficulty in rate regulation is further augmented by the historical division between intrastate and interstate jurisdictions.[136] As seen above, the court's decision in *Smith v. Illinois Bell Telephone Company* provided the legal foundation for the separations system.[137] "Separations" was the name of the procedures by which regulators divided assets and costs between the state and federal jurisdictions. "Settlements" was the term for similar averaging procedures worked out between AT&T and independent telephone systems. "Separations and settlements" constituted procedures by which the AT&T parent company paid local telephone operating companies for handling the local-exchange ends of long-distance traffic.[138] This historical division meant that the FCC and the state public utilities commissions (PUCs) had to come together to develop a system of ratemaking.

The complicated rate-making procedures were necessary for technical and jurisdictional reasons. The following illustration is adopted from

[135] See Chapter 4.
[136] See also Section II.1(b) above.
[137] *Ibid.*
[138] This is analogous to the international system of settling accounting rates between operators of different countries. See Section VI.5 below.

Horwitz (1989). Technically, every long-distance call must begin and end in the local exchange. A call originating, for instance, from a residence in New York to a business in Los Angeles first goes to the local exchange central switching centre of New York. The signal is then switched onto AT&T long-distance lines where it is routed to the Los Angeles local exchange central switching centre. Finally, the signal is delivered to the Los Angeles business. Local exchange facilities thus are used both to connect callers within the local exchange area and to begin and end long-distance calls. These different services share equipment and facilities. Jurisdictionally, local telephone exchanges are regulated both by state PUCs and by the FCC. Long-distance calls may be intrastate (such as telephone calls between Los Angeles and San Francisco) and hence under PUC authority, or interstate (calls between New York and Los Angeles), under the jurisdiction of the FCC.

The controversy over separations procedures was the dominant regulatory issue in the late 1930s and early 1940s. It was not until 1943 that the FCC and AT&T established a formal rule-making separations agreement.[139] Prior to this, the FCC practised the method of informal rate-setting with AT&T through "continuing surveillance."[140] This method describes the FCC practice of watching AT&T earnings and informally suggesting rate adjustments, rather than convening formal evidential hearings on rates.[141] The regulation of rates by negotiation had the effect of keeping pace with the quickly changing economic dynamics of the

[139] *In the Matter of Methods for Separating Telephone Property, Revenues, and Expenses*, Docket 6328, inquiry opened June 9, 1942, FCC Annual Report, 1942.
[140] Horwitz (1989), p. 134.
[141] Horwitz (1989), p. 129.

telephone industry, but it also had the effect of never determining actual policy.[142]

In the 1943 agreement, the FCC and AT&T negotiated a $ 50 million reduction in interstate rates, and AT&T agreed both to establish interstate rates according to the station-to-station principle and to increase the percentage of interstate revenues going to the local exchanges.[143] Although the FCC did finally establish a policy on separations, but due to the difficulty of setting rates, the process of regulation by negotiation proceeded as before.

The separations procedures provided the basis for telecommunications cross-subsidization.[144] Its common use is one of the many perplexing aspects of economic regulation.[145] This is particularly so as cross-subsidization is anti-competitive. It allows the big firm to keep entrants out or competitors to struggle by using its revenues from profitable areas to keep prices low in other areas. For instance, the restriction in competition allowed AT&T to continue as the dominant

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[142] Olufs (1999), p. 37.

[143] *In the Matter of Methods for Separating, supra.* n. 139, pp. 26-27. The agreement adopted the station-to-station calculations as opposed to the board-to-board model. In separations jargon, the switches connecting local exchanges to long-distance lines are called "boards". The telephone set in a customer's premise is called a "station". If A makes a long-distance call from Los Angeles to B in New York in a board-to-board call, the portion of the call between A and the toll board of Los Angeles is considered a local service; and the portion that goes between the boards of Los Angeles and New York is considered a toll (long-distance) call. If this call between A and B is considered a station-to-station call, the entire call is a toll call. Calculating the cost of a station-to-station call is very difficult because it requires calculating how much of the cost of the toll call should be apportioned to the local company. See Olufs (1999), pp. 38-40.

[144] Cross-subsidization involves the use of revenue from the sale of one product to subsidize the sale of another product. More specifically, the price of one product is set to exceed its average cost while the price of a second product is set below its average cost. As Viscusi explains, such pricing behaviour is perplexing because it appears to be inconsistent with both profit maximization and welfare maximization. See Viscusi (1995), p. 338. See also Richard Posner, "Taxation by Regulation", 2 *Bell Journal of Economics and Management Science* (Spring 1971), 22-50.

[145] Viscusi (1995), p. 337. Cross-subsidization of local telephone rates from long-distance revenue is still practiced heavily in developing countries' telecommunications industries, including India. See Chapter 5.

provider. In particular, subsidies are a crucial deterrent of competition. Because incumbents' local service rates were kept artificially low by implicit and explicit subsidies, new entrants would be discouraged from attempting to compete with the incumbents for local service customers.

Furthermore, the entrenched system of universal service made it difficult for competition to emerge in the US telecommunications industry.[146] Whenever a potential competitor attempted to enter the market and offer products and services in competition with AT&T, AT&T always argued that this would disrupt the smooth operations of their networks and result in decline in the quality of services provided. This would in turn affect the provision of universal service. Fearing that this could result in adverse effects to the public interest, the FCC and PUCs always treated AT&T's arguments with deference. This pattern lasted until the 1970s.[147]

Conversely, however, the separations policy - due to its high allocation of costs from local services to long-distance – drove heavy long-distance users, such as large corporations, to find alternatives to switched services, such as private networks, and thereby provided incentives for entry into the long-distance market.[148] The separations policy induced the development of new telecommunications services and the corresponding regulatory measures.

[146] Charles Kennedy, *An Introduction to US Telecommunications Law*, (2001), p. xxi.
[147] Horwitz (1989), p.129, and see Olufs (1999), p. 37.
[148] Brock (1994), p. 70.

(c) Entry Regulation

Entry policies involved restricting entry into the telephone market in order to protect AT&T and allow it to operate as a monopoly. These policies targeted new telecommunications services and new technologies. Because the FCC had developed a commitment to the natural monopoly, common carrier regulatory formula, any new service or technology was seen as a supplement to the existing system, and should not be permitted to disrupt that system. FCC policies supported AT&T as the main protector of system quality and generally considered interconnection restrictions as reasonable.[149] The *Hush-A-Phone* case[150] of 1948 demonstrates this point.

Hush-A-Phone was a company that sold, for almost thirty years, a cup-like device that could be snapped onto the telephone set with the intention of shielding the phone from other noises and assure relative privacy. AT&T began notifying its customers (predominantly department stores) that used the hush-a-phone that it was illegal and should be removed. The Hush-A-Phone company complained to the FCC requesting the FCC change AT&T's interconnection tariffs to allow use of the device. After hearings in which AT&T demonstrated that the device interfered with the quality of the transmission, the FCC unanimously agreed the device should be illegal.[151] The FCC believed that this protective regulation would best accomplish public interest goals. Hush-A-Phone then took its case to

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[149] On interconnection, see also Section I.4 above.

[150] *Hush-A-Phone Corp.*, 20 F.C.C. 391 (1955); *Hush-A-Phone v. United States*, 238 F. 2d 266 (D.C. Cir., 1956).

[151] This FCC decision was made in 1951. In 1955 an almost entirely new group of FCC commissioners upheld the initial decision.

the Court of Appeals. In 1956, to the surprise of many, the Court reversed the FCC's decisions and upheld Hush-A-Phone's contentions.[152] *Hush-A-Phone* is not only an illustration of FCC practice of protecting AT&T but also of a more liberal view in the courts with regard to telecommunications interconnection.[153]

The FCC's lack of solution to the problem of monopoly power is evident in its deferential treatment of AT&T. Notwithstanding evidence of monopoly-generated abuses and service shortfalls, the FCC chose to fight monopoly power by erecting operating barriers between telecommunications services. Voice common carrier could not also be record carriers. Common carriers could not also be broadcasters, and vice-versa.[154] With technological developments, new institutional barriers were erected, such as those between voice and data and between telecommunications and computing.

In sum, FCC policies on the regulation of rates, separations and entry demonstrate the failings of regulating a natural monopoly, and the consequent move towards liberalization and competition of telecommunications. However, the heart of the problem of telecommunications regulation during the monopoly years was the 1934 Act itself. The purpose of the 1934 Act when it was legislated was not to

[152] *Hush-A-Phone v. United States*, 238 F. 2d 266 (D.C. Cir., 1956).
[153] The court's liberal view, however, is limited to holding that if an interconnecting device does not physically impair any of the facilities of the telephone company, any commission restriction on interconnection is an "unwarranted interference with the telephone subscriber's right reasonably to use his telephone in ways which are privately beneficial without being publicly detrimental." The court did not instruct the FCC to deregulate customer premises equipment (CPE) nor to introduce competition. *Hush-A-Phone* v. *US* (1956), 269.
[154] Common carrier or common communications carrier is the US term for public telecommunications operator and does not include broadcasters. Telephone and telegraph operators are common carriers. See Section 3(10) Communications Act 1934, as amended, 47 U.S.C. 153.

secure competition, but the opposite. Its purpose was to create a single body to regulate a monopoly. The Act itself did not specifically state this, but hearings before the passing of the Act reveal such an objective.[155] From 1934 to the 1970s, the FCC was trying to do what it was established to do.

The problem the FCC faced in carrying out its regulatory duties also stemmed from the fact that its mandate when it was established in 1934 was vague and general.[156] Its obligation was broad: to ensure nation-wide and world-wide wire and radio communication service on a universal basis at reasonable rates.[157] The 1934 Act also states that the FCC must carry out its obligations in the public interest. However, it does not go further and detail how the FCC should achieve its objectives.

When the FCC was established technical arrangements and economic institutions in the communications industries already existed.[158] The common carrier industries were already virtual monopolies while the broadcasting industry ran on a commercial system. Furthermore, institutions 'regulating' these industries already existed (the ICC and the Federal Radio Commission). The powers and authority of these agencies were transferred to the FCC. The FCC thus constructed a system of

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155 See U.S. Senate, 73rd Congress, 2nd Session, Committee on Interstate Commerce, Hearings on *A Bill to Provide for Regulation of Interstate and Foreign Communications by Wire and Radio, and for Other Purposes* (S. 2910), March 9, 13, 14, 1934; U.S. House of Representatives, 73rd Congress, 2nd Session, Committee on Interstate and Foreign Commerce, Hearings on H.R. 8301, April 10, May 9, 10, 11, 1934.

156 Lundstedt and Spicer also raised this point in their discussion of latent policies that arise within the FCC with respect to regulating local ownership of television stations. They state: "One important factor is vagueness in statutory guidelines for FCC policy. The Communications Act of 1934 [...] provides only that the FCC act in the 'public interest, convenience, and necessity.' The vagueness of the Congressional directive allows the FCC the discretion to evolve its own policies hence make possible a divergence between manifest and latent policy." S. Lundstedt (ed.) (1990), p. 293.

157 Section 1 Communications Act 1934, 47 U.S.C.151. See also Section II.3(b) above.

158 Horwitz (1989), p. 126.

regulation that favoured pre-existing institutions and services.[159] As Horwitz observed:

> If there were a bottom line to communications regulation, it would be that the FCC acted to safeguard the continuous provision of service to the public. The regulation of telecommunications was essentially protective because, despite problems, the system *worked.*[160]

However, the rapid change in technology, with emerging innovations in telecommunications, soon proved that the FCC's policy of maintaining a monopoly in the interest of providing an efficient and reliable telephone service to the public was out-dated, and that the time had arrived for reform of the US telecommunications system.[161]

III. Towards Competition and the Idea of Deregulation

Five main factors opened up the US telecommunications industry to competition and deregulation. First, as already shown, the method of using rate regulation based on rate-of-return, coupled with the historical separations system, presented numerous problems, in particular cross-subsidy. Second, there were pressures to the efficiency of AT&T and its provision of services in the public interest caused by technological advances, and increase in user demand from large and new telecommunications users. Third, the equipment market was not a natural monopoly and therefore its regulation cannot withstand the potential entry of competitors to the market;[162] so that the economic

[159] Horwitz (1989), p. 127.
[160] Horwitz (1989), p. 128.
[161] See L. Waverman in A.Phillips (ed.) (1975).
[162] The hush-a-phone device is a case in point.

rationale to regulate this market could not hold. Fourth, anti-trust problems contributed crucially to the undermining of AT&T's long period of regulatory protection. Fifth, the political climate began to change towards liberalism. This is particularly important as changes in public policy and political theories define the transformations of regulatory polices on telecommunications in each era.

A number of institutions played their part in the evolution of US telecommunications from monopoly regulation to liberalization and deregulation: the federal regulator (FCC); the state regulators (PUCs); the federal courts; the Department of Justice (DOJ); and Congress, responsible for the 1934 and 1996 Acts. The most influential players were, however, the FCC, the DOJ and the courts.

This section examines the events leading up to the end of the monopoly period and the beginning of the competition age. The DOJ, towards the end of the 1940s, took up the political challenges to the Bell System.

1. *Second Anti-trust Suit against AT&T: 1949*[163]

The DOJ and the Federal Trade Commission (FTC) complement the regulatory work of the FCC. These two institutions are in charge of anti-trust law.[164] Federal anti-trust law has played a key role in the regulation

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[163] The first anti-trust suit against AT&T was in 1913 which resulted in the Kingsbury Commitment. See Section I.4.

[164] The primary US anti-trust laws are the Federal Trade Commission Act, ch. 311, 38 Stat. 717 (26 September 1914) (15 U.S.C. 41-58); the Clayton Act, ch. 323, 38 Stat. 730 (15 October 1914) (15 U.S.C. 12-27 and 29 U.S.C. 52-53); and the Sherman Anti-trust Act, ch. 547, 26 Stat. 209 (2 July 1890) (15 U.S.C. 1-7).

of telephony and to a lesser extent, broadcasting and television.[165] The FCC, unlike the DOJ which has the power to initiate an investigation into alleged anti-competitive conduct, has only investigatory powers over subsidiaries of carriers and therefore lacked the authority to force divestiture of the Bell System. Thus, it was the DOJ that challenged the Bell system in the courts through anti-trust suits.

Before the break-up of AT&T in 1984, to most Americans "telephone company" and "Bell" were synonymous.[166] The Bell System, which included AT&T, twenty-two Bell-operating companies, Western Electric, and Bell Telephone Laboratories, was virtually a vertically integrated monopoly. This very nature of the Bell System led the DOJ to file an anti-trust suit in 1949 alleging that Western Electric's control of the equipment market violated the Sherman Antitrust Act.[167]

The DOJ sought to divest Western Electric from the Bell System; it sought to separate an unregulated equipment supply market from the provision of monopoly-regulated services.[168] In 1956, however, the suit, after considerable delay, was settled before going to trial.[169] The consent decree that settled the matter contained the following terms.[170] AT&T was allowed to keep Western Electric, and the Bell telephone companies were

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[165] Lee and Prime (2001), p. 328.
[166] Gerald F. George, "The Federal Communications Commission and the Bell System: Abdication of Regulatory Responsibility", 44(3) *Indiana Law Journal* (Spring 1969), p. 459 at 459.
[167] [0]Unlike the 1913 and 1974 anti-trust cases against AT&T, the 1949 case was not triggered by the complaints of competitors. Alan Stone, *How America got On-line* (1997), p. 44.
[168] Horwitz (1989), p. 141.
[169] Because AT&T was a major supplier to the Defense Department at the time, the beginning of the Korean War caused the Secretary of Defense to request a postponement of the suit to avoid interference with the mobilization effort. Brock (1994), p. 71.
[170] *Consent Decree in United States v. Western Electric*, Civ. No.17-49 (D.N.J., Jan. 23, 1956). Hereinafter the 1956 Consent Decree.

not required to have their equipment requirements placed on a competitive bid basis. In other words, the government accepted the integrated corporate relationship between AT&T, Western Electric, Bell Labs and the associated operating companies. The 1956 Consent Decree thus left the Bell System largely unchanged and its monopoly intact.

In return, AT&T and Western Electric were limited to the telephone business. The Decree generally restricted AT&T to the provision of common carrier communications services, except for government and defense-related work. AT&T also agreed that Western Electric would no longer manufacture radio broadcasting transmitting equipment and television station apparatus, but to limit production to telephony equipment required by AT&T and its operating companies. Furthermore, AT&T agreed to license its Bell System patents to all interested parties at reasonable royalty rates. This allowed any applicant the use of some 8600 existing AT&T patents, including the important transistor patent.[171]

The 1956 Consent Decree created an operating barrier for AT&T.[172] But this barrier relied upon a technological distinction that was soon to become obsolete: the distinction between telecommunications and data processing, and the related boundary between common carrier and non-common carrier activities. This boundary is the source of the distinction between value-added and basic telecommunications services which characterized the US regulation of telecommunications, and later became

[171] Horwitz (1989), p. 141.

[172] Most significantly, by agreeing to restrict itself to telephony AT&T essentially agreed to stay out of computers - a new area of technology that would grow to become the foundation of today's information society. See Horwitz (1989), pp. 143-145.

a controversial issue in the GATT and WTO attempts to liberalize trade in telecommunications services.[173]

AT&T survived divestiture with the aid of the FCC and the Defense Department.[174] It argued that divestiture would result in increases in costs and the lowering of quality of service if foreign, non-Bell, equipment were attached to the telephone system. Furthermore, the FCC asserted that it could competently regulate a vertical monopoly in the public interest.[175] These arguments influenced the DOJ's decision to settle the case, as they believed they would lose if the case went to trial.[176]

Politics and the public philosophy of the time influence regulatory policies. During the 1949 anti-trust suit, anti-trust philosophy was the government's driving engine in public policy. Government policies were aimed at promoting competition and avoiding such events like the Great Depression (1929-1932). Fear of post-war depression was high and the Truman administration pursued vigorous anti-trust action. The 1949 case against AT&T was one of numerous cases launched against some of America's biggest firms and monopolies.[177]

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[173] See Chapter 4.

[174] Horwitz (1989), p. 128 and 142-3; Olufs (1999) pp. 42-43; Brock (1994) pp. 71-72; Stone (1997), pp. 46-48.

[175] Horwitz (1989), p. 143.

[176] *Ibid.*

[177] Anti-trust cases during this period included those against General Electric; the Great Atlantic and Pacific Tea Company, at the time the US's largest food retailer; the large tobacco companies; and American Can Company, the US's largest manufacturer of tin cans. Stone (1997), pp. 43-4.

2. The Road Towards Competition

The other factors that influenced the change in regulatory policies were AT&T's inability to meet new user demands in the late 1950s and the development in technology. The pressure of high demands came mostly from big business users. In the post-war period important users began to see telecommunications as a crucial way of transacting business.[178] The petroleum industry, in particular, provided a crucial push towards the expansion and diversification of services and network systems. The need for radio communications for off-shore rigs, oceangoing-vessels, petroleum pipelines and geophysical exploration impelled the petroleum industry to develop their use of telecommunications. Other industries soon came to discover their value. Regulatory agencies were faced with new issues such as whether to allow these industries to have the choice of a private system, interconnection rights and frequency allocation.[179]

In addition, the invention of television created high capacity demands from networks wanting to transmit television signals to their affiliates which AT&T facilities were unable to meet.[180] Furthermore, technological innovation in telecommunications made it possible for entrepreneurs to enter telecommunications and it exacerbated user demands to bypass the regulated system. The arrival of microwave technology in particular

[178] Stone (1997), p. 55.
[179] *Ibid.*
[180] Waverman (1975), p. 232; Horwitz (1989), p. 223.

generated competitors to the Bell System.[181] AT&T's insufficient capacity, along with the lobbying of large telecommunications users, consequently pushed the FCC to permit the entry of new providers of "specialized" telecommunications services.[182]

In the previous section, we identified the DOJ's role in the development of the US telecommunications industry. Here, it is the federal regulator and the judiciary who played crucial parts in the industry's evolution from monopoly to competition. This is particularly so in the cases examined below, where, for instance, the FCC's decision in favour of AT&T and against the new independent provider has led the independent operators to appeal to the courts.[183]

Beginning in the 1960s, the FCC and the courts took several major steps towards relaxing regulation in some telecommunications markets, for instance equipment and private long-distance. The FCC began to allow competition at the margins in order to solve the demand problem and carry out its duty in the public interest, but did not foresee the domino effect it would have. The decisions of the FCC to allow competition in private lines and terminal equipments during the 1960s and 1970s set in motion the process of liberalized entry.

Five cases are examined below in the exploration of the underlying movement from monopoly to competition. The decisions in these cases generated a domino effect towards liberalization. We will also see the

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181 Microwave technology was researched and developed under the military. Thus there was no proprietary patent situation as there would be for AT&T's inventions. The development of microwave technology therefore allowed radio equipment firms to enter the telecommunications industry as competitors. In addition, because microwave used radio frequencies, communication services could be offered without having to go through AT&T's carrier networks.

182 Horwitz (1989), p. 223.

183 *Hush-a-phone* case; *MCI* case (Section III.2(c) below).

emergence of interconnection issues as an important component in the liberalization of the telecommunications sector and more significantly, the introduction of competition.[184]

(a) The *Above 890* case

The *Above* 890 decision concerned the newly developed ability of companies to transmit long-distance messages by microwaves.[185] Big businesses such as banks, insurance companies and oil companies often sent data by "private lines" as opposed to long-distance "public lines". Private lines went from one company installation to another without going through AT&T's long-distance switches, and were relatively expensive. Businesses therefore wanted to purchase their own microwave equipment to cut costs and have the security of their own systems. In the *Above 890* case, the FCC had to decide on the allocation of the microwave portion of the radio frequency spectrum. For the first time in an FCC proceeding, virtually all big business – led by the petroleum industry – came together to provide a unified front against AT&T to contend that they needed privately provided microwave to serve their unique requirements.[186] This would potentially foreclose AT&T and other common carriers from a large volume of traffic.

In the case, the FCC established a presumption in favour of the authorization of new communication services, permitting the

[184] See Section I.4 of this Chapter, and see Chapters 4 and 5.
[185] *In the Matter of Allocation of Microwave Frequencies in the Band Above 890 Mc.*, 27 F.C.C. 359 (1959).
[186] Stone (1997), p. 56.

establishment of private transmission facilities for all private line services, including video delivery. The FCC rejected AT&T's argument that licensing private systems would cause irreparable harm to universal service and an increase in the cost of service.[187] The Commission acknowledged that AT&T had not met the demand for private point-to-point systems. More importantly, the FCC noted that competition would promote innovation in both technology and services.[188]

The decision, however, applied only to a business's internal communications, not connection to AT&T's lines, and prohibited companies from sharing non-AT&T private lines. It opened the door to the building of new and eventually competitive long-distance networks. Companies could now acquire their private line services elsewhere if AT&T did not offer what they wanted or, if there were cheaper alternatives.

The *Above 890* decision had little direct effect on the industry, but it had three very important indirect effects.[189] First, the delimited liberalization of entry set the stage for subsequent decisions that would open entry more widely to other specialized services.[190] Second, the FCC's decision also undermined AT&T's dominance of the telecommunications industry.[191] Third, AT&T's response to *Above 890* with "TELPAK", a bulk private line discount service, engaged practices that reawakened old

[187] The FCC viewed private microwave as an exception to the common carrier control of intercity communications, and thus regarded it as unnecessary to discuss boundary questions between public and non-public services. *Above 890* at 412 (1959), and see Stone (1997), p. 56.
[188] *Above 890* at 414.
[189] Horwitz (1989), p. 226.
[190] For instance, the *Carterfone* decision and the *MCI* case; see below.
[191] Stone (1997), p. 56.

antitrust fears.[192] Regulatory policies were changing in response to developments in the industry.[193] The road to liberalization had been laid.

The *Above 890* decision also signalled a turn in FCC procedures. Previous to this decision, the FCC conducted its regulation of AT&T through informal negotiations behind closed doors. In the *Above 890* case, large businesses came together for the first time to argue that restrictions on equipment manufacture and rate structures were in violation of the law. To deal with the contending sides, the FCC had to use its formal hearing process, thus opening up political debate.

It must however be recognized that the FCC was merely allowing some competition to fill the demand gap that AT&T could not fulfil, and ensure that telecommunications services were provided on a universal basis. The door to competition was opened a crack by the FCC's decision in *Above 890*, but the following cases would push it wide open.

(b) *Carterfone* case

The FCC's decision in the *Carterfone*[194] case represents a turning point in the regulation of AT&T.[195] The Carterfone device connected the national telephone land line system with two-way mobile radios to provide radio

[192] AT&T's reaction to the *Above 890* decision with TELPAK in 1961 produced the first long-distance price competition in telephones. It was also the first time rates were being set based on cost. AT&T, in trying to compete with new private line providers, used a cost-based pricing scheme (marginal cost pricing), as favoured by most economists and the system used in today's liberalization of telecoms. However, AT&T's competitors argued it was driving other competitors out of the business by pricing at rates less than actual cost. In 1976, the FCC, worried by this and the size and power of AT&T, made TELPAK illegal. See Olufs (1999), pp. 43-44. *In the matter of Amer. Tel. & Tel. Co. Long Line Dept.*, FCC Docket No. 18128, 61 FCC 2d 587 (1976).

[193] See beginning of Section III on these changes.

[194] *In the Matter of Use of the Carterfone Device in Message Toll Telephone Service*, 13 FCC 2d 420 (1968), recon. denied, 14 FCC 2d 571 (1968). Hereinafter *Carterfone*.

[195] Olufs (1999), p.46.

telephony to, for example, oil drillers located too far away from local networks. When attached to a phone, the Carterfone allowed direct communication to take place between the mobile radio user and those using the telephone network without the need for base station operator to relay the messages manually. AT&T did not offer such an equivalent. Oil companies became very important customers of Carter Electronics, the company that made the Carterfone, and because offshore drilling became an important activity of the oil industry during the 1960s, the American Petroleum Institute strongly endorsed the Carterfone's value at the FCC hearings.[196]

The FCC, in 1968, ruled that companies could connect to the public network and that AT&T had to provide standards for equipment used for connection.[197] *Carterfone* opened the telephone attachment (equipment) market generally, notwithstanding AT&T's attempt to restrict competition. This decision thus affected AT&T's equipment monopoly. By the late 1960s, the turn in the direction of telephone regulatory policies extended into services as well.

In *Carterfone,* AT&T argued that interconnection should not be allowed because it would impair the safety and quality of the network. The FCC not only found against AT&T, but used its decision to establish new equipment interconnection principles. The FCC held that there was "no material distinction between a foreign attachment such as the Hush-a-Phone and an interconnection device such as the Carterfone so far as the

[196] Further endorsements came from utilities, the US Air Force, the National Aeronautics and Space Agency, the Antitrust Division, and within the FCC, the Common Carrier Bureau. Stone (1997), p. 59.
[197] *Caterfone* (1968).

present problem is concerned."[198] The new rule advanced by the FCC stated that,

> a customer desiring to use an interconnecting device to improve the utility to him of both the telephone system and a private radio system should be able to do so, so long as the interconnection does not adversely affect the telephone company's operations or the telephone system's utility for others.[199]

This case signaled the beginning of competition in the equipment sector of the telecommunications industry. As in Europe and India, liberalization and introduction of competition started off in the equipment market.[200] The equipment market was not a natural monopoly. The argument that the equipment market should not be regulated but left to competitive market forces had been made twice before the *Carterfone* decision.[201]

(c) *MCI*

If the Carterfone case marked the beginning of competition for equipment, the *MCI* decision in 1969 introduced competition into the long-distance market, once AT&T's stronghold.[202] In 1963, Microwave Communications, Inc. (MCI) filed a Section 214 Communications Act application with the FCC for authorization to construct and operate a point-to-point microwave

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[198] *Carterfone*, 13 FCC 2d 420 (1968), 423-4.
[199] *Ibid.*
[200] See Chapter 5. A corollary to this is the indication that it is easier to liberalize goods than it is to liberalize services, being a more intangible situation. This is true domestically and internationally. See for instance the case of the GATT/WTO in Chapters 3 and 4.
[201] First, the Walker Report of 1935 reported that the equipment market was not a natural monopoly; see Horwitz (1989), pp. 137-9, and FCC, *Proposed Report: Telephone Investigation* (1935). Second was the anti-trust suit of 1949 that led to the 1956 Consent Decree. These two incidents both explored the issue of allowing the equipment market to function under competitive conditions.
[202] *In Re Applications of Microwave Communications, Inc.*, 18 F.C.C. 2d 953 (1969).

common-carrier system from Chicago to St. Louis and intermediate points.[203] Its proposed service would be both intrastate and interstate. As expected, AT&T opposed this and petitioned the FCC to deny MCI's application.

The FCC, usually a supporter of AT&T against competition, found in favour of MCI to be a specialized carrier of the proposed route so as to meet the interoffice and interplant communication needs of small businesses.[204] By four to three, the FCC established a competitor to the Bell System.[205] The decision created a market for private line systems, and represented a change in policy towards possible competition.

Predictably, MCI's success encouraged others to seek entrance to other forms of long-distance transmission. This is a good illustration of the revised theory of natural monopoly on the influence of "potential entry" into an industry.[206] MCI possessed the same technology as AT&T and more importantly, had the ability to cater for demands which AT&T failed to meet. The costs for MCI to enter the private line systems market were no greater than what AT&T would incur.[207] MCI had the ability to be a direct competitor to AT&T in this market. The potential entry of other competitors into the telecommunications industry therefore weakened the justification that the industry required regulation because it was a natural monopoly.

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[203] To obtain authorization under S. 214, MCI had to prove that present or future "public convenience and necessity" require the construction and operation of the new line.
[204] *MCI* (1969).
[205] The tight voting showed the divided opinion in the FCC about introducing competition into the telecommunications long-distance sector. The dissenters objected mainly for the effects the decision would have on long-term policy for the AT&T network. Olufs (1999), p. 47.
[206] See Section II.1(a) above.
[207] See Waverman (1975), pp. 232-233.

Regulation of the telephone industry was guided by economic as well as social reasons, but it was also a part of the political machinery. As Horwitz noted, the *MCI* decision "in some respects [...] also reflected the influence of the environment of regulatory activism".[208] During this period, the capture theory - where the regulated firms had effectively seized control or "captured" their regulators - was widespread.[209] The 1970s saw an increase in political pressure on the FCC to lower barriers to new competitors entering AT&T businesses. These pressures led the FCC and federal courts to move more towards competitive principles.

(d) *Specialized Common Carrier*

The MCI decision in 1969 only gave MCI permission to service the St. Louis-Chicago route. MCI, and other new firms, had to petition to enter each individual route thereafter, and there was a flood of applications for entry into the long-distance market since the decision. In 1971, the FCC decided in the *Specialized Common Carrier* inquiry finally to allow free entry into the private line systems market for services that the specialized common carriers would provide.[210] It was a unanimous decision in favour of competition.

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208 Horwitz (1989), p. 227.

209 The capture theory explains that regulation is supplied to serve producer interests as opposed to the public interest. See W.A. Jordan, "Producer Protection, Prior Market Structure and the Effects of Government Regulation", 15 *Journal of Law and Economics* (April 1972) 151-176; T. Makkai and J. Braithwaite, "In and Out of the Revolving Door: Making Sense of Regulatory Capture", in *A Reader on Regulation* (Baldwin, Scott and Hood, eds.) (1998).

210 FCC, *First Report and Order*, FCC Docket 18920, "Specialized Common Carriers", June 3, 1971, 29 FCC 2d 870.

Nonetheless, the FCC's conception of competition in the *Specialized Common Carrier* decision was a narrow one. The FCC did not allow or expect the specialized common carriers to compete directly against AT&T. The decision was to allow them to enlarge the market with new services which AT&T had insufficiently provided. It permitted specialized carriers to provide services in private line only, but not public switched services provided by AT&T and other authorized common carriers. The decision opened up the private line market to competition while AT&T's traditional long-distance switched services remained protected. Nonetheless, market entry standards were relaxed by the *MCI* and *Specialized Common Carrier* decisions.

(e) The *Execunet* decision

The *Execunet* case is an important example of the judicial role in the deregulation process. In 1975 MCI offered a service ("Execunet") which effectively duplicated AT&T's regular message toll service (MTS).[211] They began this without FCC approval and the FCC ordered MCI to stop, ruling that MCI had been authorized to offer private line services only.[212] The Court of Appeals, however, reversed the FCC's decision, ruling that once the FCC had licensed a firm to provide *any* service, it could provide *every*

211 In the US, switched long-distance (toll) service is often called message toll service (MTS). It is a toll service that allows the caller to access any other subscriber on the network through the switching machines of the long-distance company and the relevant local exchange companies. It is the same as "fixed-line long-distance service" or "national long-distance service". International telephone voice services are called IMTS (international message telephone service).

212 *In the Matter of MCI Telecommunications Corp.*, 34 R.R. 2d 539 (1975), 37 R.R. 2d 1339 (1976), *rev'd sub nom.* MCI Telecommunications Corp. v. FCC, 561 F.2d 356 (D.C. Cir. 1977), *cert. Denied sub nom.* MCI Telecommunications Corp., 434 U.S. 1040 (1978).

service (with the same equipment) unless the FCC specifically denied it the right to do so. The FCC had not so stipulated.[213]

The Court significantly ruled that new entrants were legally entitled to interconnection. In another reversal of an FCC decision, the court ruled that AT&T must provide local interconnections for Execunet and similar services.[214] This opened up the entire long-distance market, public and private, to competition for the first time: AT&T's protected exclusivity for long-distance public switched services was ended. The Court's activist role not only paved the way for greater competition, it also questioned the legitimacy of AT&T's monopoly: "... there may be good reasons for according AT&T *de jure* freedom from competition in certain fields; however, one such reason is not simply that AT&T got there first."[215]

Since the Execunet case, we see a move towards competitive principles in policy-making in both the FCC and the courts.

IV. The End of a Monopoly: the Divestiture of AT&T

By the 1970s, US public policy began to welcome competition and deregulation for the telecommunications industry. The rationale for a natural monopoly of the telephone industry was weakening significantly, and the direction for regulation of the telecommunications industry began to take a different turn. We now examine how the third anti-trust suit against AT&T culminated in the breaking-up of the world's largest

[213] *MCI Telecommunications Corp.* v. *FCC*, 561 F.2d 356 (D.C. Cir 1977).
[214] *MCI Telecommunications Corp* v. *FCC*, 580 F.2d 590 (D.C. Cir., 1978).
[215] *Ibid.*, at 380.

corporation and the end of an era of government-endorsed monopoly in US telecommunications.

1. *The 1974 Anti-trust Suit*

In November 1974, the DOJ filed an anti-trust suit in the federal district court against AT&T, Western Electric and Bell Telephone Laboratories, Inc. (the Bell system) alleging that AT&T had used its monopoly power to exclude other manufacturers from making customer equipment and to exclude long-distance competitors from interconnections. More specifically, the DOJ charged the defendants with three offenses: monopolization, attempt to monopolize and conspiracy to monopolize the telecommunications services and equipment markets. There were two issues to the 1974 suit: that the equipment market should be open to competition due to its questionable natural monopoly status, and interconnection.

The 1974 DOJ challenge to the monopoly powers of AT&T was much more comprehensive than the 1949 one which ended with AT&T remaining a monopoly. The 1974 suit, which sought the divestiture of Western Electric and some or all of the Bell Operating Companies, would, in 1982, lead to the eventual break-up of AT&T. This marked the beginning of the liberalization and deregulation process of the entire US telecommunications industry.

2. The Undermining of Telecoms Regulation as a Natural Monopoly

The examination of the 1974 anti-trust suit reveals four main issues. First, the attempt by AT&T to avert the success of the suit by roping in the help of Congress involved political mechanisms. Second, the case against AT&T was based on legal issues; namely, abuse of its monopoly position in the areas of equipment and long-distance telecommunications services (in particular regarding interconnection), cross-subsidization and anti-competitive conduct. Third, institutional issues on the ability of the FCC to effectively monitor a monopoly in the public interest were raised by the DOJ. This issue was linked to the fourth issue, whether regulation of a monopoly or enforcement of anti-trust law was the better solution for the telecommunications sector.

(a) Political mechanisms

AT&T, as expected, resisted the process of deregulation at all costs. It denied all the charges made against it and determined to fight the case through the legal system. In the six years before the trial in January 1981, AT&T asked Congress to enter the debate after failing to win the support of the FCC or the Court of Appeals.[216] The FCC, in the mid-1970s began taking an anti-protectionist stance on AT&T – in the Second Computer Inquiry, begun in 1976, it pointedly moved toward pro-

216 The Defense Department as usual supported AT&T by rejecting any break-up of the Bell system because of its potentially adverse impact on defense procurement.

competitive deregulation.[217] In 1979, the FCC Chairman and the Common Carrier Bureau Chief even suggested publicly that AT&T should be broken up.[218] Congress during these years attempted to reform the Communications Act of 1934, but a consensus could not be reached and no changes were made to the law.

The size and complexity of the suit, in addition to the political issues surrounding it, seemed to jeopardize the chances of success. But when the case was reassigned to Judge Harold Greene in June 1978, following the death of the Judge originally in charge, he laid down strict deadlines and implemented procedural devices to narrow the issues.

(b) Legal issues

The government's case did not challenge the existence of AT&T's monopoly but alleged that AT&T had used its monopoly to leverage its operations in the long-distance service and the equipment markets, thereby impeding competition. Technological innovations allowed for the growth in competitors in the telecommunications long-distance and equipment markets and the government had been using regulation to allow competition to develop in those markets.[219]

The government introduced evidence that AT&T had monopolized both the long-distance telecoms market and the equipment market. The government contended that the Bell System used its leverage in its

[217] *In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations* (*Second Computer Inquiry*), Notice of Inquiry and Proposed Rulemaking, 61 FCC 2d 103 (1976), and Final Decision, 77 FCC 2d 584 (1980).
[218] *Telecommunications Reports*, Vol. 45, Nov. 12, 1979, 5 as cited in Horwitz (1989), p. 238.
[219] See *Above 890*, *Carterfone*, *MCI* and *Specialized Common Carrier* discussed above.

monopoly control over the local exchanges to control the potentially competitive long-distance and manufacturing markets by cross-subsidizing the competitive enterprises with revenues from the monopoly sectors and by using various forms of discrimination (particularly with regard to local exchange access).

(c) Failure of the FCC: regulation v anti-trust

The DOJ also introduced evidence that public utility regulation was incapable of preventing this anti-competitive conduct. The argument was that regulatory failure of the telecommunications industry as a monopoly necessitated the divestiture of AT&T. So central was this argument to the government's case that it called former high-ranking FCC employees to testify that regulators were finding it difficult to supervise the Bell System's mix of monopoly and competitive (or potentially competitive) lines of business.[220] In essence, the underlying question was whether the problems were properly addressed by regulation, as AT&T claimed, or by an anti-trust solution, as the DOJ argued.[221]

In the end, technological innovations that allowed for the growth in competitors in the telecommunications market, the inability of AT&T to meet the demand for services of large corporations, the change in the political climate towards regulation in favour of competition all contributed to the divestiture of AT&T and the idea that the time had arrived for the

[220] Joseph Kearney, "From the Fall of the Bell System to the Telecommunications Act", 50 *Hastings Law Journal* (August 1999), p. 1395 at 1409.
[221] See Stone (1997), pp. 91 and 95. J. Kearney (1999), p. 1409.

deregulation of telecommunications. Legal and technological innovation eventually dismantled the Bell monopoly.[222]

3. *The MFJ and the Break-up of AT&T*

On 8 January 1982, AT&T agreed to a settlement of the anti-trust suit proposed by the DOJ. The consent decree[223] that settled the case required break-up of the Bell system. In August 1982, Judge Greene entered the Modification of Final Judgment (MFJ),[224] which slightly modified the divestiture provisions voluntarily agreed by the parties.[225] The MFJ also rescinded the 1956 Consent Decree that ended the 1949 anti-trust suit, and thereby lifted the constraints on AT&T to operate in non-common carrier markets. Thus, the MFJ allowed AT&T finally to enter other areas of telecommunications, such as broadcasting, the media and computers.

On 1 January 1984, the divestiture of AT&T came into effect and the Bell system came to an end. In its place emerged the new AT&T which was made up of long-distance services, a manufacturing arm (Western Electric) and Bell Labs.[226] These businesses AT&T managed to retain from its divestiture, while having to give up its 22 wholly owned local operating

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[222] Alan Reynolds, "For Whom the Feuding Bells Toll", *The Washington Times*, 3 August 2003, and also at http://www.cato.org/research/articles/reynolds-030803.html. We recall that technological innovation lowers entry barriers and therefore the argument for potential competition and the crack in the natural monopoly theory.

[223] Stipulation for Voluntary Dismissal, U.S. District Court, District of New Jersey, *United States* v. *Western Electric, & AT&T*, Civil Action No. 17-49, in *Decision to Divest*, Vol. 2, 900-923, 1294-1302.

[224] *United States* v. *AT&T*, Modification of Final Judgement, 552 F.Supp. 131. (Hereinafter MFJ).

[225] While substantially accepting the terms agreed to by AT&T and the DOJ, Judge Greene, in order to strengthen the financial viability of the local telephone companies, permitted them to provide, but not manufacture, customer premises telephone equipment and to publish the Yellow Pages. In addition, he stipulated that AT&T would no longer be able to use the logo or name "Bell" (except in the case of Bell Telephone Laboratories).

[226] Bell Labs is now called Lucent.

companies (Bell Operating Companies or BOCs). After the divestiture, the 22 independent BOCs were owned by seven regional holding companies, called Regional Bell Operating Companies (RBOCs).[227]

The 22 BOCs (also known as 'Baby Bells') were allowed to retain monopolies in local markets,[228] while competition was introduced in the long-distance market. The MFJ divided the country into 164 Local Access and Transport Areas (LATAs), and, subject to certain exceptions, allowed the BOCs to provide telecommunications services within (intraLATA), but not between (interLATA) the LATAs.[229] Basically, the BOCs were permitted to provide local telephone services and "long-distance" service *within* LATAs, but not between LATAs, and so barred from the long-distance market.

This approach of preventing these companies from combining monopoly and competitive telecommunications businesses was designed to ensure economic separation of the companies with the ability to impede competition (i.e. the BOCs, by virtue of their local monopolies) from the companies with the incentive to do so (i.e. Western Electric and AT&T Long-Distance Lines, by virtue of their participation in competitive or potentially competitive markets). However, it created a situation of 'asymmetric regulation'.

227 The seven RBOCs have since consolidated into four: Verizon (US's largest telephone company), SBC Communications Inc., Qwest Communications International Inc., and Bell South Corp. The original seven RBOCs were NYNEX, Bell Atlantic, BellSouth, Ameritech, Southwestern Bell, US West, and Pacific Telesis.

228 The 1996 Act would later change this.

229 The LATAs were geographical areas in which the US was divided into after the divestiture of AT&T for the purposes of regulating the new telecommunications environment. The LATAs were generally centred around a city or other identifiable community of interest, and each one marked the boundaries within which operating-company subsidiaries of the RBOCs could provide telephone service.

This by-product of the divestiture of AT&T owed its origin to the economic policies of William Baxter, the government's anti-trust chief. He stipulated that the divestiture should be based on the division of assets into regulated businesses and competitive businesses. Those that fell on the regulated side included those involved in local telephone services, and the competitive side would include equipment, enhanced services, data processing and long-distance services.[230] This distinction created the most controversial aspects of the AT&T settlement. The new companies (Baby Bells) were forbidden from manufacture or distribution of customer premises equipment (CPE) or other telecommunications products. In addition, for the same reason, they were excluded from the interexchange long-distance and information-service businesses. More generally, they were expected not to provide any other product or service, except local telephone service or local access, "that is not a natural monopoly service actually regulated by tariff."[231]

The divestiture changed the regulatory structure of the telecommunications sector from a natural monopoly regulated by an independent regulator to 'competitive' markets managed by a judge. From 1984 until 1996, the US telecommunications industry was regulated by the MFJ which was administered by Judge Greene. The district court, not the FCC, was given the authority over the BOC's entry into long-distance, manufacturing, and other businesses.[232] As a result, they lobbied Congress and the executive branch for a decade seeking congressional legislation to allow them to enter the long-distance market. The end-

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230 Stone (1997), p. 100.
231 Section II (D)(3) MFJ (1982).
232 Section VII MFJ (1982).

product was the 1996 Telecommunications Act, the first relevant legislation since the 1934 Communications Act.

From 1984 until 1996, the FCC continued to regulate interstate telecommunications, including AT&T's price and rates.[233] Virtually every AT&T price change became a political issue. For example, if the proposed price seemed too high to the FCC or its competitors AT&T was accused of exercising its power as an oligopoly. If price was too low, AT&T risked accusations of predatory pricing. As Olufs observes:

> Although the evidence suggests that AT&T did neither of these, the decision-making process was subject to formal complaints and hearings. The FCC process was more quasi-legislative than quasi-judicial in nature, which opened the process to a wide variety of political interests.[234]

To summarize, the US telecommunications industry, after fifty years of legally endorsed monopoly, was transformed by the biggest break-up in corporate history.[235] Widespread acceptance of the ideas of competition and deregulation propelled telecommunications politics to national attention.[236] By the early 1990s these notions were the cornerstone of the economic policies of both US political parties. The Reagan years marked a

[233] The FCC adopted the rate-of-return formula on AT&T, while leaving its competitors to go unregulated, because AT&T still dominated the long-distance market. In March 1989, the FCC abandoned rate-of-return regulation and adopted price caps. In the UK, the government chose to regulate BT, since its privatization in 1981, through price caps (RPI-X formula), rejecting the US style of rate-of-return due to its numerous flaws. The UK was the first to introduce the RPI-X formula. The US has now adopted this formula. Alan Bell in *Oftel News*, Issue No. 62, November 2003, p. 10.

[234] Olufs (1999), p. 66. Contrast this with the FCC's practice of informal regulation of 'continuing surveillance' through negotiations during the monopoly era.

[235] See Stone (1997), Chapter 5.

[236] Olufs (1999), pp. 67-68.

change in accepted views of public administration and the civil service.[237] Reagan declared that "government is the problem".[238]

Due to the dramatic development in technology over recent decades, particularly computers, digital technology and the Internet, the telecommunications landscape is no longer defined by a simple and clear division between common carrier, subject to natural monopoly regulation, and broadcaster, operating through competitive markets, while censored by the FCC. Regulation, as sanctioned by the 1934 Act, was not able to keep up with technological advances. The 'convergence' of telecommunications technology, the break-up of the Bell system and the increase in data telecommunications beyond plain voice traffic signalled the need to revise regulatory policy and to re-examine the rationale for regulation.

V. The Telecommunications Act of 1996

The 1996 Telecommunications Act is a modern response to this new era of telecommunications convergence and increased competition. President Clinton, signing the Act in 1996, declared that it was a "truly revolutionary legislation that will bring the future to our doorstep."[239] The goal of

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[237] Cf. Reagan's era coincides with Margaret Thatcher's time in government during which the UK government embarked on mass privatization of its infrastructures, including telecommunications.

[238] Olufs (1999), p. 68.

[239] President Bill Clinton, "Remarks by the President at the Signing Ceremony for the Telecommunications Act Conference Report", 8 February 1996. It was the Clinton administration which led the way towards the era of information superhighway: the NII initiative ('National Information Infrastructure'). The NII was not simply about telecommunications deregulation – the administration believed that the Internet would grow into a major commercial network and was in some ways a new form of commerce. The administration was primarily driven by the economic development goal, and they believed that new information technologies were the key to such growth. Olufs (1999), pp. 68-9.

Congress was to create a legislative change as dramatic as the evolution of the old-fashioned telephone, carrying voices over distant wires, into telecommunications, and the transmission of information, including data and video. With the 1996 Act, the monopolistic local telephone company is forced to share its market, while at the same time, being permitted into the competitive world of long-distance service and the potentially competitive video market. In the words of the FCC:

> In the old regulatory regime, government encouraged monopolies. In the new regulatory regime, we and the states remove the outdated barriers that protect monopolies from competition and affirmatively promote efficient competition using tools forged by Congress.[240]

The question is what is meant by competition? One answer concerns the number of competitors while the other applies behaviour criteria such as rivalry in price and quality. Competition in the Clinton administration meant 'managed competition', in other words, the telecommunications industry was not to be completely deregulated, but re-regulated for the promotion of competition. The FCC was given more flexibility to decide where increased competition would be feasible. These new powers are contained in the 1996 Act provisions on forbearance and the promotion of competition.

Regulation of telecommunications today is to promote competition in this service industry, with the aim of bringing about greater efficiency in services and development that would ultimately serve the public interest.

240 *In re* Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Part II, *Order*, 61 Fed. Reg. 45, 476, 45, 479 (1996).

1. *Changes to the US Telecoms Framework: Regulation for the Promotion of Competition*

The 1996 Act revoked the 1982 decree that settled the AT&T anti-trust suit,[241] and government agencies, mainly the FCC, were ordered to make policies that would manage a transition to a more competitive industry. The 1996 Act was enacted to "promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."[242] To achieve this objective, the 1996 Act contains two key elements: deregulation and promotion of competition in the different telecommunications markets.

(a) Deregulation

The primary statutory mechanisms for deregulation are the FCC's forbearance authority and the Biennial Review. Section 401 of the 1996 Act amends the 1934 Communications Act by adding a new Section 10 which contains the forbearance authority:

> The Commission shall forbear from applying any regulation or any provision of the Act to a telecommunications carrier or telecommunications service [...] if the Commission determines that such regulation is not necessary to ensure that the charges, practices [...] in connection with that telecommunications carrier or service are just and reasonable and are not unjustly or unreasonably discriminatory [and] forbearance is consistent with the public interest.[243]

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[241] See Title VI of the Telecommunications Act 1996.
[242] Preamble, Telecommunications Act 1996, Pub. LA. No. 104-104, 110 Stat.56 (1996).
[243] 47 U.S.C. 160

In making its decision, the Commission must consider whether forbearance will promote competitive market conditions.[244] If the Commission finds that forbearance will promote competition, that determination may be the basis for a finding that forbearance is in the public interest.[245] The 1996 Act stops short of full deregulation by giving power to the FCC to make a discretionary decision when not to apply a regulation in the public interest. The regulation is still there, but the FCC can hold back from enforcing it if the public interest is thereby served.

Further deregulatory reform was introduced into legislation by Section 402(a) of the 1996 Act that added Section 11 on Biennial review to the 1934 Communications Act. Under this new provision, the Commission is required to review, in every even-numbered year beginning in 1998, all regulations issued under the Act and has to determine whether it is no longer necessary in the pubic interest as the result of meaningful economic competition between providers of service.[246] The Commission must repeal or modify any regulation it determines to be no longer in the public interest.[247] Forbearance and the biennial review process are "critical components of Congress's vision of a pro-competitive, deregulatory telecommunications marketplace."[248]

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[244] *Ibid.*
[245] *Ibid.*
[246] 47 U.S.C. 161
[247] *Ibid.*
[248] Kathleen Abernathy, "My View from the Doorstep of FCC Change", 54(2) *Federal Communications Law Journal* (March 2002), p. 199 at 211.

(b) Promotion of competition

On the promotion of competition, the 1996 Act added Part II, "Development of Competitive Markets", to Title II to the 1934 Communications Act.[249] This new Part contains provisions on interconnection, resale, removal of barriers to entry, and requirements for unbundling the local loop[250] as part of the legislative undertaking to promote competition in the telecommunications sector.

Section 251 of the amended 1934 Communications Act establishes a general duty for all telecommunications carriers to interconnect with the facilities and equipment of other telecommunications carriers.[251] More specifically, it imposes a broad duty on incumbent local exchange carriers (ILECs – the 'Baby Bells') to provide any requesting telecommunications carrier "non-discriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms and conditions that are just, reasonable, and nondiscriminatory",[252] technically known as 'local loop unbundling' (LLU). It is important to note that this concept has been exported by the US and imported into the WTO framework on basic telecommunications as Section 2.2 of the Reference Paper.[253]

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[249] Section 101(a) Telecommunications Act 1996.
[250] Local loops are the wires that run from telephone exchanges into homes and offices. Local loop unbundling (LLU) is the process whereby incumbent telephone operators share their networks with rival companies seeking to provide telecommunications services. By allowing competitors to lease or resell lines, at least until competing networks have been constructed, regulators have been able to foster competition in both telephony and broadband access. The US local loop unbundling regime is known as UNE-P (Unbundled Network Element Platform).
[251] Section 251(a) Communications Act 1934 as amended.
[252] Section 251(c)(3) Communications Act 1934 as amended.
[253] See Chapter 4.

The irony of LLU is that, although it is often described as deregulation, it actually means more regulation. In order to tackle the continued dominance and monopolies of the ILECs, regulators force incumbents to share their networks with rival companies, thus requiring close and continuing regulatory oversight to ensure that incumbents play fair, set reasonable rates and act quickly when problems arise.[254] Nonetheless, access to the local loop by competitors is vital to the immediate introduction of competition to telecommunications, as costs of entry through network facilities building are enormously expensive for new entrants. LLU is a prime example of regulation to promote competition.

Section 251 of the amended 1934 Act is the first formal adoption, at the national level, of an aggressive competition policy in local-exchange services. It terminates the monopoly of local telephone companies permitted by the MFJ. It also allows cable television firms to compete with traditional local telephone companies.

In addition to opening up the local market to competition, the 1996 Act for the first time permits the BOCs to enter the long-distance market.[255] As the goal of the 1996 Act is to make the US telecommunications industry wholly competitive, once the bottleneck is eliminated through the opening of the local exchange, the theory is that there will be no further need to exclude the BOCs from entering new businesses like long-distance services. Once the bottleneck is eliminated there will be no danger that the local exchange service provider can

[254] *The Economist*, "Beyond the Bubble: A Survey of Telecoms", 11 October 2003, p. 19.
[255] Section 151(a) of the 1996 Act; Section 271 of the 1934 Act as amended.

leverage monopoly power emanating from control of the local exchange.[256] However, there is a 14-point 'competitive checklist' that the BOCs must satisfy before they may compete in the long-distance market.[257] In March 2003, Verizon became the second RBOC to obtain authorization to provide long-distance services throughout its region.[258] Verizon, and any BOC approved to enter the long-distance market must, however, continue to comply with Section 271 checklist requirements; the FCC can ensure compliance through such methods as imposing penalties or suspending approval.[259] In September 2003, the FCC further approved a BOC's entry into long-distance services by authorizing SBC to provide in-region, inter-LATA service in Michigan.[260]

2. *The 1996 Act: the Flaws*

The implementation of the 1996 Act, through deregulation and effective competition, has proved difficult for the FCC, and its benefits have not been as rapidly seen as the lawmakers had hoped. Some have pointed out that the failure to achieve effective competition lies in the flaws inherent in the 1996 Act itself.[261] The 1996 Act suffers from the same shortcoming as the original 1934 Act: the legislations were adopted "in the public

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256 Kathleen Wallman, "A Birthday Party: The Terrible or Terrific Two's? 1996 Federal Telecommunications Act", 51(1) *Federal Communications Law Journal* (December 1998), p. 229.
257 Section 271 Communications Act 1934 as amended.
258 FCC News, 19 March 2003, available at http://www.fcc.gov.
259 Section 271 (d)(6) Communications Act 1934 as amended.
260 FCC News, 17 September 2003, available at http://www.fcc.gov.
261 Aimee Adler, "Competition in Telephony: Perception or Reality? Current Barriers to the Telecommunications Act of 1996", 7 *Journal of Law and Policy* (1999), p. 571 at 584 and 624; Randolph May, "The Pubic Interest Standard: Is It too Indeterminate to Be Constitutional?" 53(3) *Federal Communications Law Journal* (2001), pp. 427-468.

interest".[262] The 1934 Act was adopted in the public interest to correct a market failure – the telephone industry was a natural monopoly. The 1996 Act, on the other hand, was enacted in the public interest to address the issue that the telecommunications industry was no longer a natural monopoly but needed to be deregulated and competition promoted. The public interest standard continues to permeate throughout the new Act. The public interest standard is, however, vague, indeterminate and depends on the public policy of the time.

This has, for instance, resulted in few of the provisions of the 1996 Act reflecting, strictly speaking, precise policies.[263] Most of them require the FCC to make new rules, often without precise legislative direction except that they must be "in the public interest". For instance, the Act requires the FCC to establish a new regulatory framework to promote local services competition, stating:

> *Within 6 months* after the date of enactment of the Telecommunications Act of 1996, the Commission shall complete *all actions necessary* to establish regulations to implement the requirements of [Section 251].[264]

This implementation of the controversial local loop unbundling regime has been of particular problem. The FCC's efforts to implement the regime have led to legal challenges by incumbents trying to slow down the unbundling process, having twice reached the Supreme Court. Moreover, by 2003, the US LLU policy was still not implemented, further made difficult by disagreements between Chairman Powell and Commissioner

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[262] R. May (2001), pp. 447-452; and see beginning of Section II above and *supra.* n. 56.
[263] Olufs (1999), p. 92.
[264] Section 251(d)(1) 1934 Act as amended. Emphasis added.

Kevin Martin on the best policies.[265] The FCC nonetheless managed to adopt new rules on LLU in February 2003.[266] However, this new Order gave a substantial role to the state commissions in regulating LLU, and once again the FCC's efforts, challenged by the Baby Bells, were struck down by the Court of Appeals in March 2004.[267] These two elements, state utility commissions intervention and federal court rulings, were what policy-makers were hoping to lessen by the new 1996 Act. The continued division of roles between state and federal regulators, a hazard of the US federal system, remains a weakness in US telecommunications regulation.

In December 2004, the FCC adopted new rules to implement the LLU regime, directly responding to the Court of Appeals' decision.[268] The FCC must hope that the legal challenge to its LLU rules stops here.

VI. US Policies on the Global Liberalization of Telecommunications

Despite flaws in the 1996 Act as a regulatory framework for telecommunications, the US has exported strong principles of telecommunications regulation - namely competitive safeguards, non-discrimination, transparency, reasonable terms, conditions and rates, interconnection and unbundled access - into the WTO framework, and has

[265] See *The Economist*, "When stars collide", 13 February 2003, and "The FCC presses auto-destruct", 27 February 2003, at http://www.economist.com; FCC News, "FCC Adopts New Rules for Network Unbundling", 20 February 2003, at http://www.fcc.gov.
[266] FCC News, 20 February 2003.
[267] See FCC News, "FCC Adopts New Rules for Network Unbundling Obligations of Incumbent Local Phone Carriers", 15 December 2004.
[268] *Ibid.*

similar policies on the liberalization of international telecommunications services.[269]

As the landscape continued to change dramatically, after the end of AT&T's monopoly era, US policies shifted from a purely domestic focus to issues of competition from foreign entrants and international telecommunications services. This section examines the new playing field in US telecommunications with the following themes in mind. First, competition since the 1984 divestiture occurred initially among new domestic entrants in the recently opened markets. For example, in long-distance, competitors to AT&T wasted no time in setting up and offering competing networks and services, and competing firms could now enter the local services market. Furthermore, there has been an increase in the number of firms providing international telecommunications services.[270] As competition began to expand the US telecoms market and make it profitable, it became attractive to foreign companies, in particular those offering international telecommunications services.

Second, as the US telecommunications sector became more competitive many firms competed fiercely against one another, making it more difficult for them to survive. These firms needed to expand abroad and search for other specialization in order to evolve and stay alive in the new and highly competitive market. AT&T, for one, began expanding

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[269] International telecommunications services are telecommunications services provided between countries, i.e. originating from one country and terminating in another country. International telecommunications services are provided either on a facilities-based or pure resale basis.

[270] In 1997, 52 international carriers reported providing facilities-based services, and 318 carriers reported offering international services on a resale basis, up from 230 in 1995. WTO, *US TPR, Report by the Secretariat*, 1 June 1999, para. 43.

overseas and specializing in data communications services and the Internet.

The third theme is the WTO. The WTO is central to the movement to secure the liberalization of trade and favourable conditions abroad. With the US telecommunications market for the most part liberalized, and US telecoms firms seeking to find comparative advantages in markets abroad, the US government turned its attention to extending liberalization beyond its shores. To expand trade in telecommunications services and ensure US firms could participate on an equal level playing field with dominant incumbent providers in foreign markets, the US sought binding liberalization commitments by governments through multilateral frameworks like the WTO. For instance, although telecommunications liberalization was taking place in most other developed countries towards the end of the 1980s and throughout the 1990s, many, predominantly developing countries, still maintained state-owned telecommunications providers, which had control of their domestic markets.[271] Even if the domestic market might be experiencing competition from other domestic providers of telecommunications services this did not mean the market was open to foreign carriers. The opening of domestic markets to foreign participants became a US objective, to be achieved through clear and binding multilateral rules.

The second and third themes are the subjects of Chapters 3 and 4. In this section we discuss US regulatory policies on international telecommunications services and the opening up of the US market to foreign providers of telecoms services. The US sees its policies as

[271] India's biggest provider, BSNL, is today still 100% state-owned.

furthering its traditional leadership role in promoting trade liberalization and developing a system of benefit to all.[272] Consequently, US domestic policies on telecommunications liberalization often have extraterritorial effects.[273]

The FCC liberalized and promoted competition in trade in telecommunications services in four main ways. First, the FCC encouraged competition in international services among domestic suppliers through deregulation of its Section 214 authorization requirement (International Competitive Carrier policies). Second, as competition increased in the international services market, the FCC applied the same deregulatory policies to non-dominant foreign telecoms carriers entering the US to provide international services. Third, the FCC determined the nature of other countries' telecommunications markets through application of its domestic standard on entry of foreign carriers into the US market (ECO test), and forbade the entry of foreign suppliers whose country of origin did not provide 'effective market access' to other foreign entrants. Fourth, the FCC influenced foreign countries' rates for international services through setting benchmarks (maximum rates) for which US domestic operators are allowed to agree to in their settlement rates agreements with other countries' operators as part of the international accounting rate system (Benchmark Order 1997).

[272] The US aims to achieve this through "global, regional, and bilateral trade agreements; encouraging developing countries' multilateral integration; building support for open trade; encouraging sustainable development and core labor standards; and fostering greater transparency". WTO, *US TPR: Report by the Government*, WT/TPR/G/88, 20 August 2001, p. 23.
[273] See the FCC's Market Entry Order 1995 and the Bench Mark Order 1997, below Sections VI.3 and VI.5.

The relevance of these FCC procedures to the international aspect of telecoms liberalization was the significant effect US domestic policies had on the negotiations of the GATT and the WTO to obtain greater liberalization commitments from other WTO member countries.

1. Regulation of Foreign Carriers in the US Telecoms Sector

The two legal bases for FCC regulation of foreign carrier provision of telecommunications services in the US telecommunications market are Sections 214 and 310 of the Communications Act 1934. Section 214, the US licensing provision for common carriers, deals equally with domestic and foreign carriers. It states that no carrier - including foreign carriers wishing to provide telecommunications services in the US - can construct new lines or extend existing lines, or acquire or operate any line, without first obtaining authorization from the FCC.[274] The FCC must find that granting such a license would serve the "public convenience and necessity."[275]

The 1996 Act did not make changes to Section 214. Nonetheless, in 1999, the FCC has modified its rules to grant blanket entry certificate to all domestic carriers to provide,

> domestic, interstate services to any domestic point and to construct, acquire, or operate any domestic transmission line as long as it obtains all necessary authorizations from the Commission for use of radio frequencies.[276]

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[274] Discontinuance of services also requires FCC approval. Section 214(a), 1934 Act (47 U.S.C. 214).
[275] Section 214(a) Communications Act 1934.
[276] *In the Matters of Implementation of Section 402(b)(2)(A) of the Telecommunications Act of 1996: Forbearance of the Independent Telephone & Telecommunications Alliance*, Report and Order, CC Dkt. No. 97-11, Second Memorandum Opinion and Order in AAD File No. 98-43, released June 30, 1999, Appendix B Final Rules. The FCC has chosen to confer blanket authority instead of using its power of forbearance from exercising its Section 214 jurisdiction.

These deregulatory provisions do not, however, apply to foreign carriers or to international services. Nonetheless, the FCC could use its forbearance authority under Sections 10 and 11 of the amended Communications Act to its regulation of international services and foreign carriers wishing to enter the US market. It could promote competition in the US telecoms market through finding that forbearing from restricting entry of foreign carriers would promote competitive conditions in the US telecommunications market.

The other provision the FCC uses to control entry of foreign carriers into the US domestic market is Section 310 of the Communications Act of 1934 which deals solely with foreign carriers. Section 310(b) prevents a carrier that is more than 20 per cent foreign-owned, or a carrier affiliated with a carrier that is more than 25 per cent foreign, from holding a broadcast or common carrier radio license in the US. Section 310 does not apply to wire line,[277] or to non-common carrier (satellite systems) services. Section 310 contains the only restrictions on foreign investment in the Communications Act.[278] There are no prohibitions on foreign entities from investing in companies that hold Section 214 authorizations.[279] The 1996 Act thus provides for substantial domestic liberalization of services and allows entry of foreign carriers to many areas of business, but maintains some restrictions on direct foreign ownership, as well as discretionary power regarding indirect foreign ownership.

[277] For example, fibre optic cable, cable television, telephone lines.
[278] WTO, NGBT, *US Response to Questionnaire*, S/NGBT/W/3/Add.13, 21 October 1994, para. 6.
[279] Such foreign entities may operate on a resale basis, build their own non-radio facilities or operate a mixture of the two.

2. *Introducing Competition into the International Telecommunications Market: the International Competitive Carrier Policies*

The FCC's first major attempt to promote competition in international telecommunications was in 1985 in the form of the International Competitive Carrier Policies.[280] The ICC Policies were an extension into international telecommunications services of the Competitive Carrier proceeding, consisting of six reports and orders over five years,[281] which dealt with the loosening of regulation of non-dominant carriers (carriers without market power) in the US market. The FCC initiated the Competitive Carrier proceeding in 1979 in the aftermath of a number of Commission decisions, discussed above, which permitted entry into the domestic market by new service providers, and led to the deregulation of US telecommunications and the divestiture of AT&T.[282]

The importance of the Competitive Carrier line of decisions is in the finding by the FCC that, in a competitive environment, market forces could protect the public against unreasonable high rates and undue discrimination.[283] That is, marketplace forces could replace regulation.

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280 *In the Matter of International Competitive Carrier Policies*, Report and Order, CC Dkt. No. 85-107, 102 FCC 2d 812 (1985); *In the Matter of International Competitive Carrier Policies*, Notice of Proposed Rulemaking, CC Dkt. No. 85-107, 100 FCC 2d 1270 (1985). (Hereinafter *ICC Policies*).

281 These reports and orders are collectively known as the Competitive Carrier Rulemaking: *First Report and Order*, 85 FCC 2d 1 (1980); *Second Report and Order*, 91 FCC 2d 59 (1982), recon. FCC No. 83-69, released March 21, 1983; *Third Report and Order*, Mimeo No. 012, released October 6, 1983, 48 Fed. Reg. 46, 791 (October 15, 1983); *Fourth Report and Order*, 95 FCC 2d 554 (1983); *Fifth Report and Order*, FCC No. 84-394, released August 27, 1984, 49 Fed. Reg. 34824, September 4, 1984; *Sixth Report and Order*, FCC No. 84-566, released January 4, 1985, 50 Fed. Reg. 1215 (January 10, 1985).

282 See Section III.2.

283 *ICC Policies*, Notice of Proposed Rulemaking, CC Docket No. 85-107 (1985), para. 3.

Less regulation, moreover, allows carriers to respond to consumer desires at the lowest price on a timely basis.[284]

In the context of the liberalization of telecommunications services, the *Competitive Carrier* decisions illustrate that the process began in the US as early as 1980 while most developed countries' telecommunications were still monopolies. With each Report and Order on competitive carriers, the FCC in the early 1980s introduced deregulatory policies and progressive competition to US domestic telecoms. This gave the US experience, which it later brought to the negotiating tables of the GATT and WTO.

The FCC's Competitive Carrier decisions created two classes of carriers for interstate and international long-distance services: "dominant" and "non-dominant".[285] The FCC classified dominant carriers as those that have "market power" – the ability to affect price or availability of service.[286] The FCC in determining "dominant" status considered a number of factors, including market share, control of bottleneck facilities, rate of return, and actual or potential competition.[287] The FCC classified as dominant AT&T, the Baby Bells, Comsat and telephone companies in US "offshore points", such as the Virgin Islands and Puerto Rico. Carriers that were found to be dominant were subject to the full panoply of regulatory rules because market forces could not be expected to exert the necessary restraint on carrier facility decisions and pricing practices.[288] Dominant domestic carriers are required to file cost-supported tariffs (for

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284 *Ibid.*, para. 9.
285 Cf. the EC's equivalent of operators with 'significant market power' (SMP) and the WTO Reference Paper's 'major supplier'.
286 Competitive Carrier Rulemaking, *First Report and Order* (1980), 85 FCC 2d 1.
287 *ICC Policies*, Notice of Proposed Rulemaking (1985), para. 32.
288 Competitive Carrier Rulemaking, *First Report and Order* (1980).

their service) on 45 days advance notice. The FCC must authorize dominant carriers' acquisition of transmission capacity.

Non-dominant carriers, on the other hand, did not have market power or the ability to set price. Therefore, the FCC reasoned, regulation of these carriers could be streamlined.[289] It followed that the FCC no longer required non-dominant domestic carriers to obtain specific authorization to construct new or additional lines. Because AT&T was subject to strong competition in its business services, the FCC has streamlined its regulation of those services and treats AT&T as a non-dominant carrier for business services. Tariffs of non-dominant carriers are presumed lawful, need not be cost-supported, and only require 14 days advance notice.[290]

In 1985, the FCC decided that the time was ripe to reconsider the regulation of international services market and that there were adequate reasons for reducing regulation for *some* international service providers. The FCC applied the dominant/non-dominant distinction to the international services market with the adoption of the International Competitive Carrier Policies, which streamlined its regulation of non-dominant international carriers.[291] They reasoned that firms lacking market power do not have the ability to maintain prices unreasonably

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[289] *Ibid.*, p. 20.

[290] To recall, the FCC, in 1999, finally deregulated entry requirement for all domestic interstate carriers. See Section VI.1.

[291] *Report and Order*, 102 FCC 2d 812 (1985).
In this context, 'international carriers' are US (domestic) carriers providing international telecoms services - distinct from foreign-owned carriers providing international services, which were still subject to full S. 214 regulation. See 102 FCC 2d 812, 842 (1985).
In 1992, the FCC, in a deregulatory move, modified this policy to regulate international carriers - US and foreign-owned - "as dominant only on those routes where their foreign affiliates has the ability to discriminate unaffiliated US international carriers through control of bottleneck services and facilities in the foreign market." *Regulation of International Common Carrier Services*, CC Dkt. No. 91-360, 7 FCC Rcd 7331 (1992).

above or below cost. Thus, non-dominant international carriers were required only to obtain an initial authorization under Section 214 and thereafter could add or discontinue circuits on a route without prior specific authorization.

In the ICC Policies, the FCC analyzed the international services market and concluded that there were two separate and distinct product markets: IMTS (international message telephone services – basically international voice telephony) and non-IMTS (e.g. telex, telegram, high and low speed data, private line and video). The FCC concluded that due to the limitations of carriers to freely provide international services to a given country and difficulties in shifting facilities to serving one country to serving another, there were substantial restraints which limit the provision of international service to a country-by-country basis.[292] Each country was a separate geographic market - unlike domestic services which operate in a single market.[293]

Having found that each nation constitutes a separate geographic market and that the product markets are defined as IMTS and non-IMTS, the FCC considered whether any firm was dominant in a given market. The FCC used the traditional anti-trust analysis in terms of "the power to control prices or exclude competition",[294] and used its analysis in the Competitive Carrier decisions for the international services market to determine dominance. A finding of dominance for any firm would lead the FCC to conclude that the marketplace would not ensure either that services would be priced competitively or that operators would employ

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[292] *ICC*, Notice of Proposed Rulemaking (1985), para. 29.
[293] *Ibid.*
[294] *ICC*, Notice of Proposed Rulemaking (1985), para. 31.

practices consistent with the Communications Act. Consequently, the FCC concluded that a finding of dominance would justify the continued application of full regulation under Title II (Common Carrier) of the 1934 Act. In addition, all carriers providing non-IMTS were deemed by the FCC to be non-dominant and subject to stream-lined regulation.[295] The importance of the ICC Policies to the WTO context lies in its analysis of dominant and non-dominant suppliers and the effects such categorization have on determining the nature of foreign domestic markets.

The ICC Policies, however, covered only the regulation of domestic international service providers, and not foreign providers wishing to enter the US market to provide international services. No clear rules or standards existed in this area, until the FCC adopted the controversial ECO test in 1995.

3. *The ECO Test (Market Entry Order)*

In November 1995, the FCC issued the Market Entry Order[296] and adopted the effective competitive opportunities (ECO) test, which became effective in January 1996, as the standard for regulation of entry of foreign carriers into the US international telecommunications services market. The significance of the FCC policy in the Market Entry Order is in its extraterritorial effect.

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[295] *Ibid.*, para. 49.

[296] *Market Entry and Regulation of Foreign-Affiliated Entities*, IB Docket No. 95-22, Report and Order, 11 FCC Rcd. 3873 (1995). (Hereinafter "Market Entry Order").

(a) Application of the ECO test and criteria to be met

The FCC created a two-step 'barrier' process for foreign carrier entry application in the Market Entry Order. In addition to obtaining a Section 214 authorization from the FCC, a foreign carrier must now first pass the ECO test before it is given authorization to enter the US international telecoms services market, either directly or through an "affiliation" with either a US facilities-based or resale carrier.[297] The ECO test is specifically applied in cases of foreign applicants with market power in the destination market.[298] There are a number of criteria to satisfy before a foreign carrier can pass this new standard.

First, there must be effective market access in the primary market, or markets, of the foreign carrier seeking entry.[299] The FCC defines effective market access as the ability of US carriers to provide basic, international facilities-based telecommunications services in these markets,[300] and the

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[297] In general, for the purposes of applying the ECO test under Section 214 of the Act, the FCC considers an applicant to be affiliated with a foreign carrier when a foreign carrier owns a greater than 25 percent interest in, or controls, the applicant. Market Entry Order, para. 4.

[298] Market Entry Order, para. 19. It applies to applications for international facilities-based, switched resale, and non-interconnected private line resale under Section 214. The ECO test is also applied to common carrier radio applicants or licensees that seek to exceed the 25 per cent indirect foreign ownership benchmark contained in Section 310(b)(4).

[299] Market Entry Order, para. 23.

[300] *Ibid.*

FCC will consider six factors it believes to be indicative of effective market access.[301]

Second, the FCC would assess other public interest factors relevant to entry of a foreign carrier in the US international market.[302] These "other public interest factors" include the general significance of the proposed entry to the promotion of competition in the US communications market, and any national security, law enforcement, foreign policy and trade concerns raised by the Executive Branch.[303] In addition, the presence of cost-based accounting rates is one of the factors the FCC must consider as part of the ECO analysis of foreign applicants.[304] According to the FCC, there may be occasions when the public interest requires that these additional factors override an ECO determination to allow or deny entry.[305]

(b) Why adopt the ECO test standard?

So why did the FCC adopt the ECO test standard for regulating the entry of foreign carriers into the US telecommunications market? The primary purpose emphasized by the FCC was "to promote effective competition in the US telecommunications services market, particularly the market for

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301 These factors are: "(1) Whether US carriers can offer in the foreign country international facilities-based services substantially similar to those that the foreign carrier seeks to offer in the United States; (2) whether competitive safeguards exist in the foreign country to protect against anti-competitive and discriminatory practices, including cost-allocation rules to prevent cross-subsidization; (3) the availability of published, nondiscriminatory charges, terms and conditions for interconnection to foreign domestic carriers' facilities for termination and origination of international services; (4) timely and nondiscriminatory disclosure of technical information needed to use or interconnect with carriers' facilities; (5) the protection of carrier and customer proprietary information; and (6) whether an independent regulatory body with fair and transparent procedures is established to enforce competitive safeguards." Market Entry Order, para. 40

302 Market Entry Order, para. 56.

303 Market Entry Order, para. 62.

304 *Ibid.*

305 *Ibid.*

international telecommunications services."[306] The Commission therefore adopted rules that were intended to constrain the market power of foreign-affiliated carriers that control bottleneck facilities in the destination market. Through the ECO test, the FCC hoped to accomplish its three goals for regulation of international telecommunications services: 1) to promote effective competition in the US telecommunications service market; 2) to prevent anti-competitive conduct in the provision of international services or facilities; and 3) to encourage foreign governments to open their telecommunications markets.[307]

The important question is what was the real reason for the adoption of the ECO test? One argument is that the extended negotiations in the WTO on basic telecommunications that were taking place at the same time as the process for adopting the Market Entry Order had an influence. The Notice of Proposed Rulemaking for the ECO test was released in 1995 - about a year after the extended negotiations on basic telecoms commenced in the WTO.[308] The Order itself was then released in November 1995. These were significant periods in the WTO negotiations on basic telecoms. By September 1995 (over a year since the negotiations began) only 8 draft offers on basic telecoms had been tabled (US among them) out of 27 participants in the Negotiating Group on Basic Telecommunications (NGBT). 27 participants out of more than 130 WTO Members at that time was a small number. The ECO Test Order could have been an indication that the US was frustrated by the lack of commitment by other WTO Member States to the liberalization of telecommunications.

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306 Market Entry Order, para. 8.
307 Market Entry Order, para. 6.
308 See Chapter 4.

Even by November 1995, five months before the NGBT was scheduled to conclude, only 14 draft offers had been received. The US, through the FCC, may have adopted the ECO test to encourage or exert pressure on foreign governments to adopt multilateral commitments to promote competition in their respective telecoms markets.[309] In any case, by the end of the NGBT in April 1996, a total of 34 draft offers were tabled, an increase of more than 100% since November 1995. The US's unilateral efforts had paid off.[310]

An alternative perspective was that the US wanted to transplant into WTO law its domestic regulatory framework on telecommunications. In particular, the Market Entry Order contained the regulatory principles of "reasonable and non-discriminatory charges, terms and conditions for interconnection", "the existence of competitive safeguards", and "the existence of an effective regulatory framework." In fact, these principles constituted the ECO test.[311] The same principles are also found in the US paper to the WTO entitled "Pro-competitive Regulatory and Other Measures for Effective Market Access in Basic Telecommunications Services"[312] which was presented to the NGBT in February 1995 and became the 'prototype' for the Reference Paper. This was not coincidence.

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309 Some commented that the ECO test was issued to improve the US's negotiating position in the NGBT. The FCC itself stated in its Order: "If the Executive Branch succeeds in negotiating greater market access for U.S. carriers in exchange for still greater liberalization of the U.S. basic telecommunications market, then we would gladly amend the rules we adopt today as necessary." Market Entry Order at 3965, para. 240.

310 In January 1996, only 17 per cent of the world's top 20 telecommunications markets were open to US companies (see below Foreign Participation Order 1997, para. 7). The US hoped that this would improve dramatically with the entering into force of the ABT together with the FCC's international policies incorporated in the International Settlement Rates Order and the Foreign Participation Order (see below).

311 See Market Entry Order 1995, paras. 46-55, and *supra* n. 301.

312 WTO, NGBT, *Communication from the United States*, S/NGBT/W/5, 9 February 1995.

(c) Criticisms of the ECO Test

Foreign carriers and foreign governments, however, saw the ECO test as a barrier to market access. They thus made elimination of the ECO test a major objective of the WTO negotiations on basic telecoms. One commentator argues that the ECO test is significantly flawed for three reasons: 1) the FCC's authority to perform such an analysis is unclear; 2) the analysis causes the FCC to inappropriately interfere with US trade policy; 3) the results are likely to have a chilling effect on the flow of investment capital into the US telecommunications market, which would be harmful to the public interest.[313]

The first criticism is shared by many foreign government commentators. The FCC, however, argued that it had jurisdiction to adopt the ECO test under Section 214 and Section 310(b)(4) of the 1934 Act:

> The fact that Congress did not require us to consider specifically the openness of foreign markets under Section 214 in no way implies that this factor is not relevant under the broader concept of the public interest, convenience and necessity.[314]

On the second point, the FCC also rejected arguments that it was engaging in trade issues outside its mandate. It insisted that the Order is,

> fully consistent, not only with [its] responsibility to promote the US *public interest,* but also with the responsibility of the Executive Branch to formulate and execute US international trade policy.[315]

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313 Eric Schmidt, "International Telecommunications Transactions: a Critique of the FCC's 'Effective Competitive Opportunities' Analysis", 7 *Duke Journal of Comparative and International Law* (Spring 1997), p. 629 at 629. See also Market Entry Order, paras. 220-244.

314 Market Entry Order, para. 227.

315 *Ibid.* para. 239. Emphasis added.

On the third point, accusations have been made that the ECO test was in substance a reciprocity requirement. Reciprocity, in trade policy, implies opening domestic markets only on condition that trade partners open theirs. This is against the spirit of open trade and could have the effect of chilling trade in telecommunications services. The FCC, however, denied this. In addition, the WTO Secretariat in its Report on the Trade Policy Review of the United States stated that the overall picture of reform in the US, mainly through adoption of the 1996 Telecommunications Act, was positive despite the concerns expressed by other countries with regard to reciprocity considerations.[316] However, the Secretariat did stress that excessive restrictions on dominant carriers' abilities to expand their services could lead to inefficiencies and that artificial barriers to entry must be used in a careful and selective manner so that they do not prevent competition. The Report concluded that the US had been applying such policies in "a careful and transparent manner."[317]

To summarize, the FCC adopted the ECO test as standards to ensure the promotion of effective competition in the US market for international services. This policy sought to influence the global liberalization of telecommunications services through extraterritorial application of its domestic policies. A new Order regulating foreign carrier entry into the US market was however adopted two years later, after the successful conclusion of the WTO negotiations on basic telecommunications.

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316 WTO, US TPR, Report by the Secretariat, WT/TPR/S/16, 21 October 1996, p. 158, para. CVII.
317 *Ibid.*

4. The Foreign Participation Order 1997

The FCC adopted the Foreign Participation Order[318] on 25 November 1997 to take into account developments on basic telecommunications in the WTO. It implemented the US commitments in the WTO Agreement on Basic Telecommunications (ABT). This Order adopted a new standard for foreign telecommunications carriers wishing to enter the US market. Effectively it abolished the ECO test for applicants from WTO Member countries and adopted an open entry standard for such applicants.[319] The open entry standard consists of a presumption that a license should be granted to a carrier from another WTO Member State unless it is shown that this carrier poses a high risk to competition in the US.[320]

In adopting this change the FCC reasoned that the commitments made in the ABT, an increasingly competitive environment and the FCC's improved regulatory tools would enable the FCC to adopt a deregulatory approach that presumed entry was in the public interest.[321] The FCC places confidence in safeguard measures, their own and those of their trading partners within the WTO framework, to act as sufficient protection against the danger of anti-competitive behaviour resulting from foreign entry into the US market. It was therefore unnecessary to maintain the ECO test as a public interest standard for entry of foreign carriers from WTO Member countries.

[318] *Rules and Policies on Foreign Participation in the US Telecommunications Market*, IB Docket Nos. 97-142 and 95-22, Report and Order and Order on Reconsideration, 12 FCC Rcd. 23 (1997). (Hereinafter "FPO").
[319] FPO, para. 2.
[320] FPO, para. 13.
[321] FPO, para. 9.

Although the FCC stated that it adopted the open entry standard for WTO Member applicants due to the open commitments that WTO Members have made in the ABT, the FCC has taken steps to revise their competitive safeguards. The Foreign Participation Order has adopted more narrowly tailored safeguards in order to enhance the FCC's ability to detect and prevent foreign carriers with market power from distorting competition in the US telecommunications market. The Order narrowed the "No Special Concessions" rule to prohibit US carriers from entering into exclusive arrangements only with foreign carriers with more than 50% of market share in the foreign market.[322] The Order also revised the safeguards that apply to US carriers classified as dominant, owing to an affiliation with a foreign carrier possessing sufficient market power at the foreign end of a US international route. The FCC adopted a rebuttable presumption that foreign carriers with less than 50 per cent market share in each relevant market on the foreign end lack sufficient market power to affect competition adversely in the US market so that their US affiliates should be treated as non-dominant.

The three main goals in the Market Entry Order[323] continue to be the goals of the Foreign Participation Order. Moreover, the FCC stated that the Foreign Participation Order would better serve these three goals for international telecommunications services than the approach outlined in that Order (which used the ECO test on all foreign entry applicants).[324]

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[322] FPO, para. 17. The No Special Concessions rule prohibits all US international carriers from agreeing to accept special concessions from any foreign carrier or administration.
[323] See Section VI.3(b) above.
[324] FPO, para. 11.

First, the FCC believes that removing barriers to entry and focusing on competitive safeguards will promote effective competition in the US telecommunications services market. Second, the FCC believes that their new approach will enable them to prevent anti-competitive conduct in the provision of international services or facilities by relying on more effective and targeted safeguards. Third, the FCC finds that this approach will encourage foreign governments to implement their commitments to open their telecommunications markets by showing that open markets and minimal regulation are beneficial to consumers and industry.[325] This marks a significant departure from two years before when the FCC issued the Market Entry Order and adopted the ECO test, and supports the theory that the adoption of the ECO test was the US response to the slow progress in the WTO negotiations on basic telecommunications.

The open entry standard for WTO Member States is not, however, applicable to applicants from non-WTO countries. Applicants from non-WTO countries must continue to satisfy the ECO test.[326] In the FCC's view, challenged by some commentators,

> It continues to serve the public interest to maintain policies directed at encouraging non-WTO member countries to open their telecommunications markets to competition.[327]

In general, the FCC has liberalized its foreign entry policy through the Foreign Participation Order and abolished the ECO test for applicants from WTO Member States. This is a clear demonstration of US leadership

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325 *Ibid.*
326 FPO, para. 15.
327 FPO, para. 125.

role in the liberalization of telecommunications services, which is crucial to the multilateral trading system generally.[328]

The streamlined procedure of the open entry standard meant that Section 214 applications could be processed within 35 days instead of 90 days using the ECO test standard.[329] In the first 90 days of the Foreign Participation Order rules, the FCC granted over 200 applications to provide international services.[330] From January to May 1998, the FCC granted 26 applications from foreign telecommunications carriers to enter the US market, including 13 applications from carriers with market power in their home market, which would otherwise have been subject to a lengthy ECO analysis.[331] Since the adoption of the Foreign Participation Order, the FCC significantly reduced the workload in the licensing arena, providing it with the ability to focus its resources on actual cases of anti-competitive behaviour, rather than the theoretical possibility in every application.[332]

In the same year as the adoption of the Foreign Participation Order and the signing of the WTO ABT, the FCC issued another Order on international telecommunications services, the International Settlement Rates Order.[333] The FCC stated that the Foreign Participation Order and

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328 For further reading on this subject, see James Bacchus, "The Bicycle Club: Affirming the American Interest in the Future of the WTO", 37(3) *JWT* (2003), 429-441; and Speech by the WTO Director-General, Dr Supachai Panitchpakdi, to the National Press Club in Washington, D.C., "American Leadership and the World Trade Organization: What is the Alternative?" (26 February 2004), available at http://www.wto.org .
329 FPO, para. 21.
330 FCC, Public Notice, 14 May 1998. Available at http://www.fcc.gov/ib/pd/pf/wto.html.
331 Ibid.
332 Paul Kenefick, 8 CommLaw Conspectus (2000), p. 43 at 50.
333 *In the Matter of International Settlement Rates*, IB Docket No. 96-261, Report and Order, FCC 97-280, adopted 7 August 1997 and released 18 August 1997. (Hereinafter ISR Order).

the International Settlement Rates Order substantially completed their plan to,

> restructure the economics of the market for US international telecommunications services [and that this] restructuring will promote the low cost, technologically innovative interconnectivity serving all the world's consumers that should be the hallmark of a Global Information Infrastructure.[334]

Unlike the Foreign Participation Order, which was welcomed by WTO Member States, the ISR Order met with fierce objections and legal action against the FCC.

5. FCC International Settlement Rates Order 1997

An important element of international telecommunications services is the international settlement rate, which is part of the international accounting rate system.[335] The system was established for the making of payments for the carriage of international telecommunications traffic. The international accounting rate system consists of the "accounting rate" and the "settlement rate". The accounting rate is the privately negotiated internal price between originating and terminating carriers. The carriers then agree to a settlement rate – usually half of the accounting rate – to hand-off and terminate traffic to each other.

The FCC established its policy for international settlement rates in the 1930s when it adopted the Uniform Settlements Policy (USP), as a

334 ISR Order, para. 1.

335 The international accounting rate regime was developed in 1865 by twenty European countries to provide for a standard, common method to divide the revenues for international telecommunications service between originating and destination countries. The principles of the international accounting rate system are contained in the ITU's International Telecommunications Regulation Article 6 and elaborated in a series of ITU Recommendations. The system operates through bilateral contractual agreements between telecommunications operators in each jurisdiction. (ITR 88, Art. 6.2.1).

result of its first case on accounting rates.[336] The case addressed the issue of "whipsawing"[337] of US telegraph carriers. In 1986, the FCC changed the name of the USP to the International Settlements Policy (ISP).[338] The ISP provides a regulatory framework within which US carriers negotiate with foreign carriers to provide bilateral US-international telecoms services. It was designed to ensure non-discriminatory treatment of US carriers by foreign carriers with market power.[339]

In addition to non-discriminatory treatment, the US has always been very concerned with high above-cost international accounting rates. With the international accounting rate system if there is an equal amount of traffic exchanged between the originating market and the destination market, then the originating and terminating carriers' "settlement of accounts" will be zero. However, the problem emerges when countries with generally more outbound traffic than incoming traffic for nearly every international route (e.g. the US) incur huge deficits in the accounting system of that country. The problem is exacerbated when the accounting rate is set far above the actual costs of terminating a call, which is often the case where the foreign carrier is a monopoly or in a dominant position.

This poses a problem for the US because in the US, one of the most competitive markets in the world, rates are lower than in many other countries and therefore a substantial amount of world telecommunications

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336 *Mackay Radio & Telegraph Company, Inc.*, 2 F.C.C. 592 (1936), affd. sub. nom. *Mackay Radio and Telegraph Co., Inc* v. *FCC*, 97 F.2d 641 (D.C. Circuit 1938).

337 Whipsawing is an anti-competitive behaviour that generally involves the abuse of market power by a foreign carrier to play US carriers against one another in order to gain unduly favourable terms and benefits. Whipsawing could lead to higher costs for US carriers and result in higher calling prices.

338 Codified at Sections 43.51 (47 C.F.R. section 43.51 (1996)) and 64.1001 (47 C.F.R. section 64.1001 (1996)) of the FCC's rules.

339 The ISP stipulates three conditions US carriers must undertake when entering into agreements with foreign carriers. See 47 C.F.R. Section 43.51 (e).

traffic is routed through the US.[340] Partly as a result of these traffic routing patterns, the US settlement deficit continued to grow steeply in the 1990s. In 1996, US settlement deficit totaled $5.4 billion, double what it was in 1990.[341]

The FCC therefore adopted the International Settlement Rates Order in August 1997 to limit the level of the US net settlement benefits. But more significantly, the point of the ISR Order is to export the liberalization of telecommunications services by compelling other countries to do away with their monopolistic practices. The FCC argues that the Order is necessary because under the current international accounting rate system the settlement rates US carriers pay foreign carriers to terminate US-originated traffic are in most cases substantially above the costs foreign carriers incur to terminate that traffic. These significant margins are then used to subsidize telecommunications services within the foreign country at a cost to US consumers who pay artificially high prices for international services.[342] This imbalance also discourages foreign carriers from introducing effective competition and cost-based pricing for all telecoms services, and can be used to finance strategies that create competitive distortions in the market for US international services.

The Order establishes benchmarks to govern the international settlement rates that US carriers may pay foreign carriers to terminate international traffic originating in the US. It requires US carriers to lower

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340 Technology has allowed innovative ways to re-route international calls to seem like it originated in another country other than the country that the call was physically being made. As the US has one of the cheapest rates, customers were using such services as call-back to change the originating country for settlement purposes to the US instead of most other countries which had monopoly markets and therefore high non-competitive international rates.

341 ISR Order, para. 13.

342 ISR Order, para. 2.

the international settlement rates paid to foreign carriers for terminating calls to a level commensurate with the economic development of the country where calls terminated. It also prohibits US carriers from engaging in international simple resale[343] unless 50% of the traffic on a particular route is settled at or below the benchmark settlement rates. All US-licensed carriers are subject to the Order, while foreign-affiliated operators' compliance is a condition of obtaining FCC approval for the provision of long-distance services to the home jurisdiction.[344]

The FCC categorized countries into three groups and set the initial benchmark rates as follows: $0.15 per minute for upper income countries; $0.19 per minute for upper middle income and lower middle income countries; and $0.23 per minute for lower income countries.[345] The FCC remarked that these rates are still above foreign carriers' costs of providing international termination services, but they will nonetheless substantially reduce the excess in current settlement rates. The Order requires that US carriers obtain commitments from foreign correspondents in settlement rates equivalent to or below the benchmark level. The FCC had also set a transition schedule intended to take into account the need to ensure a smooth transition from previous settlement rates to the FCC benchmarks as an immediate reduction of the settlement rates to the benchmark rates could result in undue disruption of foreign carriers' operations.[346]

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343 International simple resale involves routing switched traffic over international private lines that connect to the public switched network at either end-point.
344 ISR Order, para. 207.
345 ISR Order, para. 19. These rates will be revised periodically as necessary in order to keep pace with cost reductions that may occur in the future as well as to encourage further movement toward cost-based settlement rates. ISR Order, para. 112.
346 ISR Order, para. 22.

The ISR Order is a unilateral action by the US with extraterritorial effects. Not surprisingly, the Order generated opposition in many countries over the potential impact on domestic operator revenues.[347] In addition, the EC and Japan raised concerns about the compatibility of the Order with the US's commitments under the GATS, specifically the principle of MFN. Many urged the FCC to work through multilateral organizations, especially the ITU, to achieve accounting rate reform.[348]

The FCC, however, reasoned that their contribution to multilateral efforts does not have to be an exclusive means of addressing accounting rate reform. The Commission believes they can take this action to fulfill their statutory commitments to ensure US consumers receive telecommunications services at reasonable rates and to address the potential for competitive distortions in the US market for international services. Moreover, although the ITU has adopted accounting rate reform (ITU-T Recommendation D.140)[349] which called for carriers to adopt non-discriminatory, cost-oriented and transparent accounting rates within five years of its adoption in 1992, progress on implementation of those principles has been slow.[350] And with the 'gentlemen's agreement' among WTO Members to leave international settlement rates out of the WTO's multilateral system and therefore not subject to dispute settlement, the FCC's unilateral action was necessary to tackle the problem of artificially high settlement rates.

[347] Petitions for Enforcement of International Settlement Rates Benchmark Rates (4 August 2000); see Walden in Walden and Angel (2001), p. 368.
[348] ISR Order, para. 18 and footnote 23.
[349] ITU-T D.140, "Charging and Accounting in International Telecommunication Services: Accounting Rate Principles for International Telephone Services", Telecommunication (07/98) Standardization Sector of ITU. Available at http://www.itu.int/osg/spu/intset/itu-t/d140/d140_e_rev.html (8 March 2004).
[350] ISR Order, para. 17.

In 1998, Cable & Wireless brought an action before the US courts challenging the legality of the ISR Order. Over 100 other petitioners and interveners – national governments, regulators and operators – joined the case on both sides. The main complaint was that the FCC had exceeded its authority through the extraterritorial nature of the Order's provisions.[351] The court found overwhelmingly in favour of the FCC in 1999, holding that it had the requisite powers to make decisions regulating the actions of US-licensed operators, including contractual arrangements entered into for international settlement rates and that "the Commission does not exceed its authority simply because a regulatory action has extraterritorial consequences."[352]

The FCC has asserted that the ISR Order has resulted in a decrease in international settlement rates. Within a year and a half of the Order's adoption, carriers from 24 countries had reduced their settlement rates to levels at or below their respective benchmark rates, and 14 more countries have agreed to do so within the timeframe prescribed.[353] Moreover, in 1998 competitive rates that consumers pay for calls from the US to the top 10 international destinations have fallen on average by 25 per cent.[354] From 1997 to 2002, the average settlement rate for all US-outbound traffic fell from $0.35 to $0.11, and the average cost of international calls has dropped from $ 0.67 to $ 0.27.[355] Thus, the benchmark policy together with increased competition in the US market has led to dramatic decline in

351 *Cable & Wireless et al.* v FCC, 166 F. 3d 1224 (DC Cir. 1999). See http://www.fcc.gov/ogc/documents/opinions/1999/cable.html.
352 *Ibid.* See also Kenefick (2000), p. 10.
353 FCC News, 5 February 1999.
354 *Ibid.*
355 *In the Matter of International Settlements Policy Reform, International Settlement Rates Order*, First Report and Order, 19 FCC Rcd 5709, 43, adopted 11 March 2004 (*2004 Order*), para. 72.

international settlement and calling rates. The ISR Order has produced effective results.

In March 2004, the FCC, in response to changes in the international services market, adopted new deregulatory rules which reformed the ISP.[356] The *2004 Order* importantly removes the ISP from bench-mark compliant routes.[357] It also eliminated the International Simple Resale (ISR) Policy and associated filing requirements,[358] but maintains certain competitive safeguards on all routes.[359] The deregulation of the ISP should give US carriers more flexibility to negotiate arrangements with foreign carriers, and encourage market-based agreements that will result in more cost-based rates.[360] The benchmarks policy however is not removed by the 2004 Order.[361] Currently, routes between the US and 142 countries are exempt from the ISP.[362]

VII. Concluding Remarks

This chapter looked at one hundred years of the US telecommunications industry and its policies – from domestic to international. The US was the birth place of modern regulation of telecommunications as we know it today. The enactment of the 1934 Communications Act adopted a

[356] *Ibid.* These changes include increasing competition and participation in international services resulting in lower rates, and greater liberalization and privatization in foreign markets. See *2004 Order*, paras. 2,18, 21, and 23.
[357] *2004 Order*, para. 27.
[358] *2004 Order*, para. 31 and Appendix B.
[359] *2004 Order*, paras. 24-25, 40.
[360] *2004 Order*, para. 2.
[361] *2004 Order*, paras. 82, 85.
[362] The US-India route obtained exemption in November 2004. See FCC, Public Notice, DA 04-3518, 4 November 2004.

regulatory system whereby the US telecommunications industry was run by a private, as opposed to state-owned, telecommunications operator and kept in check by an independent regulator. At the time, regulation of the telecommunications industry in the US was based on the theory of natural monopoly. As technology advanced and led to the development of the telecommunications sector whereby maintaining a monopoly, albeit regulated to ensure efficiency, was not optimal nor providing the benefits or meeting consumer and business demands, the US telecommunications industry experienced a wave of changes in regulatory policies during the 1970s. The changes led to a domino effect that resulted in the divestiture of AT&T and the introduction of competition into the long-distance and international telecommunications sectors.

Beginning in the mid-1980s and continuing into the 1990s US telecommunications policies were moving towards liberalization and promotion of competition. The enactment of the 1996 Telecommunications Act opened up all sectors, most importantly the local sector, of the US telecommunications industry to competition. The FCC continues to be the most important institution in promulgating telecommunications policies which today are based on market principles and competition rules. However, the implementation of these rules and policies has proved difficult for the FCC. The problem lies, as it did during the monopoly years, in the legislation itself.

The obvious remedy is to enact a new telecommunications law: one that will truly take account of the convergence of the telecommunications industry, and remove the strict distinctions that divide the different telecommunications markets (for instance, local, long-distance) and the different technologies (wireless, wireline, for example). The new Act should be technology neutral. The new legislation should also address the issue of state-federal divide. Most importantly, it should adopt clear, concrete policy guidelines for direction of the FCC.[363] A first step would be to review the public interest standard. These changes would reduce the number of cases brought to court and the regulatory process of enabling effective competition would not be time and time again hampered by protracted litigation.

Nonetheless, with over one hundred years of regulation in the telecommunications industry, from a monopoly to liberalization and competition, the US prides itself on having the most open telecommunications market.[364] The US thus brought its liberalization, competition and regulatory policies on telecommunications services to the negotiating tables of the GATT Uruguay Round and later the WTO negotiations on basic telecommunications.

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[363] R. May (2001), p. 427 at 455.

[364] As remarked by the US, "Competition and reliance on private investment have been major factors underlying the U.S. market's strong performance." WTO, CTS, *Communication from the US*, S/C/W/91, 16 December 1998, p. 2.

Chapter 3

The Liberalization of Trade in Services

The General Agreement on Trade in Services (GATS) provides the main international regulatory framework governing trade in services, including telecommunications services. The WTO is the key international institution through which its Member countries, in particular the US, have developed telecommunications liberalization. For this reason, this chapter will explore the historical development of the liberalization process of trade in services in the GATT and the WTO, and the provisions of the GATS itself.

The services sector has grown over the past two decades to become the largest part of developed countries' GDP and employment.[1] No doubts remain today as to the importance of services to the world economy. However, services as an independent economic activity from the production of goods only began to be recognized in the late 1970s, in the US. Throughout the early 1980s the US services sector had been growing steadily, becoming an engine of growth for the US economy by the time the Uruguay Round of GATT multilateral negotiations began in 1986. The domestic growth at an increasing rate of the service sector, especially financial and telecommunications services, led to a desire to expand this activity beyond the national borders as trade. The US thus led the way towards broadening the agenda of the multilateral trade negotiations to include, for the first time, discussions on trade in services.

[1] For example, the US service sector today accounts for over sixty percent of GDP and 80% of employment. USTR, Press Release, "U.S. Offers to Expand Access to the Already Open American Services Sector in WTO Trade Talks", 31 March 2003; USTR, "Free Trade in Services: Opening Dynamic New Markets, Supporting Good Jobs", 31 March 2003.

The debate on the creation of a multilateral framework for trade in services similar to the one already in place for trade in goods (the GATT), took centre stage during the Uruguay Round negotiations. The US was the vigorous champion for a multilateral framework, with Europe and other developed countries like Japan and Canada lending support. However, fierce opposition to a multilateral system of rules governing trade in services came from developing countries, led by India and Brazil. Their main fear was that liberalization of trade in services through a multilateral system would destroy developing countries' fledgling service economies.

An agreement by all parties, reached in the last minutes leading up to the commencement of the Uruguay Round, to include trade in services in the negotiations of the new GATT round was only made possible by a "compromise" in which trade in services negotiations would be conducted on a "separate track" to that of goods negotiations. At the conclusion of the GATT Uruguay Round in 1994, the first multilateral agreement on trade in services - the General Agreement on Trade in Services – was adopted and became an integral part of the new multilateral trading body of the World Trade Organization.[2]

This chapter focuses on two areas. First, it examines the process of the liberalization of trade in services in the GATT/WTO system, particularly the development of trade in services from being only incidental to trade in goods to establishment of an international agreement of its own described as "perhaps the most important single development in the multilateral trading system since the GATT itself came into effect in 1948".[3] It begins by examining the definition of services. Next, it

[2] Although there were other international agreements on services before the GATS, for example the NAFTA and EC Treaties, these agreements are 'regional' agreements whereas the GATS is a potentially world-wide agreement.

[3] WTO Secretariat, *An Introduction to the GATS* (October 1999), p. 1.

considers the theories as to why the service sector has grown so dramatically. These explain why developed countries push so hard for trade in services to be liberalized. We will discuss the reasons behind the US's role in pushing a multilateral framework for liberalization of trade in services, and the arguments in favour of and against such a framework. Second, we will examine the GATS, and the application of the GATS framework to the liberalization of trade in telecommunications services.

I. Growth in Services Domestically

Until recently, the service sector has played "a seldom recognized role as a *necessary* and *critical* ingredient in all economic growth."[4] Before discussing how trade in services has become a dynamic force in world trade, this section will examine the meaning of services, and describe the growth of the service sector domestically.

1. Definition of Services

It has never been easy to define services unambiguously, and services include service products and service activities. Economists have attempted to define services in many different ways based on characteristics, forms of transactions and kinds of activity. Some have listed different services or classified them into different groups.

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[4] Dorothy Riddle, *Service-Led Growth: The Role of the Service Sector in World Development* (1986), p. 2.

The Penguin Dictionary of Economics defines services as "intangible, non-transferable economic goods[5] as distinct from physical commodities".[6] This definition refers to service products. Service products, in other words outputs of the production process, are, for example, a haircut and a concert. This definition describes services in terms of their 'invisible' nature and as something "you cannot drop on your foot".[7] It is a limited definition, however, as some services do involve the provision and use of tangible goods, such as construction or computer software services.

The traditional definition of service activities, on which official statistics are based, is a negative one in which services are seen as a residual: service activities are those which do not produce physical goods.[8] Under this definition, service activities are those activities that are not agriculture, mining or manufacturing. This definition may be convenient for national accounting purposes but has come under heavy criticisms in recent years. One main criticism is that this definition does not have much of an analytical basis.[9] This is because service activities cover an extremely wide range. This definition of service activities as residual, encompassing as it does such a large and heterogeneous sector, does not give us much of a framework for deeper analysis of services as a sector of the economy.[10] Moreover, services are today understood to be 'products' in their own right and not simply the effort of producing.[11]

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[5] An economic good is any physical object, natural or man-made, or service rendered, which could command a price in the market. Services defined in terms of an economic good is therefore not to be confused with goods which mean physical commodities. Bannock, Baxter and Davis, *Penguin Dictionary of Economics* (1998), p. 377.
[6] *Ibid.*
[7] *The Economist* as cited in Sven Illeris, *The Service Economy: A Geographical Approach* (1996), p.12.
[8] Sven Illeris (1996), p. 12.
[9] Neela Mukherjee, *GATT Uruguay Round, Developing Countries and Trade in Services* (1995), p. 27.
[10] *Ibid.*
[11] J. Nusbaumer, *Services in the Global Market* (1987), p. 7.

The absence of any clear theoretical basis for grouping services industries results in differences found among empirical studies. Two criteria have been identified by Fuchs as the most frequently used.[12] One is closeness to the consumer, and the other is the intangible character of services. In summary, however services are defined, the main characteristics that describe services, as compared to the manufacturing sector of the economy, are that they are more heterogeneous, mostly intangible, and more labour-intensive.

Services remain difficult to define today.[13] As we will see below in the section on the GATS, there is no definition of services in the GATS as such. The GATS restricts itself to describing "trade in services" in terms of the four different ways in which they could be supplied: cross-border, consumption abroad, commercial presence and presence of natural persons.[14] The difficulty in defining services, however, has not affected the fact that services have grown dramatically over the last century and plays an ever increasing, influential role in the world economy.

2. *Theories on the Growth of Services*

The growth of services domestically generated the growth of trade in services. The growth in the US service industry comprises more than half of the country's gross domestic product (GDP) and as such accounts in

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[12] Victor Fuchs, *The Service Economy* (1968), p. 15.

[13] How should services be defined was one of the hotly argued issues in the debates on whether services should be placed on the agenda of the Uruguay Round. During the Uruguay Round negotiations itself, almost two years was spent on dealing with the definition of services and how statistical data on services should be determined. See WTO, Working Group on the Relationship between Trade and Investment, *Communication from UNCTAD*, WT/WGTI/W/21, 6 January 1998; GATT, GNS, *Note on the Meeting of 23-25 February 1987*, MTN.GNS/7 20 March 1987; GATT, GNS, *Note on the Meeting of 29 June-2 July 1987*, MTN.GNS/9, paras. 5, 16. The WTO today is still finding ways to systemize services data collection which is problematic due to the difficulty of defining services.

[14] GATS Article I:2.

large part for the US's desire to expand its trade in services through trade liberalization. Similar trends in the growths of the service sectors in Europe and in other developed economies like Japan induced these developed countries to follow the US in the drive for the liberalization of trade in services.[15]

There are a number of theories to explain the growth of the service economy. The four main theories of service industry growth are: the three-stage development theory; growth in services as a result of increases in consumer demand for services; growth as a result of increases in producer demand for services; and growth due to lower productivity levels in the services sector than in that of agriculture and industry. We look at these theories for a background understanding as to how services have become so important to the economy not only domestically but also worldwide.

The conventional theory of service industry growth is the three-stage theory developed by Fisher and Clark.[16] This theory explains that there are three developmental stages in the economy. The primary production stage is that of agriculture. As countries developed, they moved to the second industrial stage where GDP and employment were largely involved in manufacturing. Higher personal income generated from this second stage then becomes the main factor contributing to the growth of the service sector, explained in terms of the higher elasticity of demand for services rather than goods. This last, and most mature, stage of the economy is the "service" or "post-industrial" economy, the tertiary production stage in the Fisher/Clark theory.

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[15] In the United Kingdom, for example, the service economy comprised 54.9 per cent of the GDP in 1979, rising to 61.5 per cent of the GDP in 1989, while Japan's service economy comprised 54.1 per cent of the GDP in 1979 and 56.5 per cent of the GDP in 1989. (World Bank 2000).

[16] Allan Fisher, "Primary, Secondary and Tertiary Production", *Economic Record* (June 1939), p. 136; Colin Clark, *The Conditions of Economic Progress* (1951).

The three-stage theory, however, does not adequately provide an explanation for the growth of the service industry since it merely describes "a process of economic and/or social change that results in services becoming the largest single group of economic activity or employment by occupation".[17] Other theories explain the expansion of the service industry in relation to increases in demand for services. Fuchs identifies two types of demand that could possibly account for services growth: a more rapid growth in 'final' demand for services, and a relative increase in 'intermediate' demand for services.[18]

The former refers to consumer demand for services, and the expansion of the service economy is explained in terms of the relationship of consumer spending patterns and levels of income. Services are said to be income elastic: they are affected by changes in tastes and priorities and by changes in income. As disposable income increases, so does consumer demand for services, i.e. as people grow richer, their consumption of services such as tourism, education and health, expands more rapidly than their demand for manufactured and agricultural products. Fuchs points out, however, that an examination of cross-sectional buying patterns, and of trends in out-put over time, suggests that the growth in income and a consequent shift in demand has not been a major source of the relative growth of service employment.[19] Gershuny and Miles also reached a similar conclusion after having examined data from several European countries.[20]

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[17] P.W. Daniels, *Service Industries in the World Economy* (1993), p. 15.
[18] Fuchs (1968), p. 3.
[19] He discovered that, measured in dollars of constant purchasing power, the service sector's share of output is the same in 1965 as in 1929. And if measured in current dollars, it grew only from 47 to 50 per cent. *Ibid.*
[20] Gershuny and Miles used data from several European countries to show that the real consumption of privately purchased services was in decline during the 1960s and 1970s. J. Gershuny and I. Miles, *The New Service Economy* (1983), as cited in P.W. Daniels (1993), p. 16.

Services growth has also been explained by the growth of intermediate (or producer) services. Producer services are those used by primary, secondary and tertiary activities in the process of production of a good or service rather than by final consumers. Division of labour and specialization within the production process have encouraged the demand for producer services, aided by the restructuring of production within enterprises and increased externalization of functions such as advertising, security, design, packaging and computer programming. The analysis made by Fuchs[21] over 1947 and 1958, and by Elfring[22] from 1960-1973, however, both reveal that accelerating demand for producer services provides only a partial explanation for service sector expansion, and not a principal source for the growth.

Fuchs identifies another cause for the expansion of the service sector: that the productivity level was lower in the services sector than that of agriculture and industry.[23] Therefore, even if demand is spread uniformly across all sectors of an economy, services will require an ever larger share of the labour force. He believes this to be the major explanation for the move in labour to services. This slower growth in output per person in the service sector was due to three factors: there was a greater decline in hours worked per person in the service sector than in the industry sector; there was a much more rapid increase in the quality of labour in industry than services; and there was the differential trend in physical capital per worker.

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21 Fuchs's findings show that service employment change attributable to increasing demand for producer services was less than 10 per cent of the total change. Fuchs (1968), p. 4.

22 T. Elfring, "New Evidence on the Expansion of Service Employment in Advanced Economies," *Review of Income and Wealth*, series 35, 4, (1989), pp. 409-40 as cited in P.W. Daniels (1993), p. 17.

23 Fuchs (1968), p. 4.

It would seem that a comprehensive explanation for the growth of the service economy over the last decades cannot be accounted for by a single theory. The Council for Trade in Services of the WTO suggests that the expansion of the services sector can be attributed to the income-elasticity of demand for services, the lower productivity growth in many services sectors than in manufacturing and agriculture, and the organizational changes in an economy.[24] All these factors contributed to the growth of the service economies of different countries around the world.

Today, the three largest players in world trade[25] are the US, Europe and Japan. Until recently, the US was the world leader in international trade without strong competition from Europe or Japan both seriously crippled by the Second World War. Having emerged from the war in a very favourable economic position, the US was the only major country to increase its international commerce without undue strain on its balance of payments.[26] The US moreover has continually developed its service industry through greater specialization in the different service sectors[27] and consequently became the world's first "service economy".[28] These events explain why the impetus to liberalize trade in services originated in the US.

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[24] WTO, CTS, "Economic Effects of Services Liberalization", S/C/W/26, 7 October 1997, p. 1.
[25] This includes both trade in goods and services.
[26] A.G. Kenwood and A.L. Lougheed, *The Growth of the International Economy 1820-1990* (1992), p. 241.
[27] For example, there was rapid growth in the financial, transportation and telecommunications sectors.
[28] That is, more than half of the employed population is not involved in the production of tangible goods like food, automobiles, etc. Fuchs (1968).

II. Liberalizing Trade in Services: The Role of the US in Promoting Services Internationally

The road towards a multilateral system of open trade and global liberalization can be traced back to US-led efforts after the Second World War. The US led the conferences on establishing an international monetary organization and a trade order. The former was successful in the form of the International Monetary Fund (IMF), but the latter, in the form of a proposed International Trade Organization (ITO) failed, partly as a result of domestic politics within the US which led to the Senate failing to ratify the ITO agreement, and partly because the urgency to restructure international trade subsided.[29] Nonetheless, the General Agreement on Tariffs and Trade (GATT), intended as an interim agreement, emerged by default to become the focus of legal efforts to liberalize the world's trading regime. The Protocol of Provisional Application (PPA), an agreement which was intended to permit the implementation of GATT obligations until the ITO came into being, provided the legal basis for the legal applicability of the GATT.[30]

The GATT allowed countries that were Contracting Parties to trade under a system of rules aimed at open trade in goods through the reduction of tariffs and the elimination of other barriers to trade. At this early stage in the multilateral trading system, no such scheme existed for services. It was not until the 1970s that the US – virtually unique in this

[29] John H. Jackson, *The World Trading System* (1997), p. 38.
[30] Protocol of Provisional Application of the General Agreement on Tariffs and Trade, October 30, 1947, 55 U.N.T.S. 308.

regard – recognized the growing significance of trade in this 'other sector' of the economy.

1. Services Recognized

By the 1970s the US had developed into a service economy. In 1965, the service sector share of GDP in the US was 59 per cent, with an average annual growth of 3.4 per cent between 1965-1980.[31] By 1980 this figure rose to 66 per cent.[32] The three-stage theory[33] would explain that the US had moved beyond the primary and secondary stages of development and is now in the final mature stage of services. In 1979, for example, agriculture accounted for only 3 per cent of the GDP (dropping to 2 per cent in 1989) and industry accounted for 33.6 per cent of the GDP (dropping to 28.9 per cent in 1989), while services made up 63.4 per cent of GDP.[34]

As the world's strongest service economy, the US became the largest exporter and importer of private services.[35] As a consequence, a few large US service companies, in particular insurance, financial services, travel and tourism, and information-based service sectors began lobbying for negotiations aimed at removing restrictions to trade in services.[36] These companies and multinational firms also formed an *ad hoc* group to

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[31] World Bank (1988) as cited in B. Hoekman (1990), pp. 28-9.
[32] Hoekman (1990), p 31.
[33] See Section I.2 of this chapter.
[34] World Bank (Development Economics central database), 2000.
[35] Based on IMF balance of payments statistics and national sources in the year 1970 as cited in Hoekman (1990), p. 37.
[36] J.V. Reyna, "Services", in *The GATT Uruguay Round: A Negotiating History*, Volume 2 (T.P. Stewart, ed.) (1993), p.2343; Rivers, Slater and Paolini, "Putting Services on the Table: The New GATT Round", 23 *Stanford Journal of International Law* (Spring 1987), p.13 at 16; Geza Feketekuty, *International Trade in Services: An Overview and Blueprint for Negotiations* (1988), pp. 299-300.

establish an international framework of rules governing trade in services. The mounting pressure resulted in the Trade Act of 1974.[37]

By stating that "the term 'international trade' includes trade in both goods and services",[38] the Act for the first time gave recognition to services as being internationally "tradable" and therefore mandated trade liberalization in services.[39] The Act authorized the participation of the US in the GATT Tokyo Round of multilateral trade negotiations which commenced in 1973, and directed US negotiators to seek the reduction or elimination of non-tariff barriers to international trade in both goods and services. In addition, it established an advisory committee to assist the US Government during international trade negotiations.[40] Furthermore, Section 301 granted the US President the authority to retaliate against countries that maintained or imposed unreasonable or unjustifiable restrictions on US goods and services.[41] By not making any distinction between goods and services, Section 301 acknowledged not only the growing importance of trade in services but also that trade in goods and trade in services are linked both commercially and politically and cannot be separated in the management of trade policy.[42]

Armed with the authority granted by the 1974 Act, and later the 1979 Trade Agreements Act,[43] the Carter and later the Reagan administrations vigorously took on the mission of having trade in services inscribed on the agenda of world trade. During the final stages of the

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[37] Public Law 93-618, 88 Stat. 1978 (1974) (codified at 19 U.S.C. Sec. 2411 (1990)).
[38] Trade Act of 1974, Section 102(g)(3).
[39] Bela Balassa, "The United States" in P.A. Messerlin and K.P. Sauvant, (1990), p. 129. See also Feketekuty (1988) p. 301.
[40] See Feketekuty (1988), pp. 5, 70.
[41] Trade Act of 1974, Section 301. "Section 301" is shorthand for Chapter 1 of Title III of the Trade Act of 1974, as amended, which covers some 10 sections: section 301 through 310.
[42] Feketekuty (1988), p. 198.
[43] Trade Agreements Act of 1979, Public Law 96-39, 93 Stat. 144 (1979).

Tokyo Round of the GATT multilateral trade negotiations in 1979, the US, led by Ambassador Robert Strauss, its Special Trade Representative, made an effort to introduce services trade issues, intending to lay ground work for future negotiations.[44] The Tokyo Round referred to services in the Agreement on Government Procurement, the Standards Code and the Subsidies Code, but only to the extent that services were incidental to the supply of goods.

Although the Tokyo Round did little to satisfy the US ambition of a legal framework to govern international trade in services, the US effort expanded international awareness of the importance of services. Furthermore, the US significantly obtained an informal commitment from other industrialized countries to undertake a comprehensive study of trade in services in the Committee of the OECD.[45] The objective was to determine if it was possible to identify issues in services that would lend themselves to negotiation in future trade agreements. The study revealed trade in services to be substantial, though still impeded by trade barriers, and provided the groundwork for the inclusion of trade in services in multilateral trade negotiations.[46]

2. *Efforts to Introduce Trade in Services on the Multilateral Level*

No sooner had the Tokyo Round been concluded than the need for another round of multilateral trade negotiations to include trade in services became apparent. Other developed countries gradually came to realize the importance of trade in services to their economies. In March 1980, the

[44] The Tokyo Round began in September 1973.
[45] Feketekuty (1988), p. 304.
[46] Reyna (1993), p. 2345.

GATT Consultative Group of Eighteen met and considered a Secretariat document which analyzed the link of certain services with trade in goods. The Group determined that the document "demonstrated an essential link between trade in goods and certain services" and suggested that trade in services might be a "proper concern of the GATT".[47] This was the first substantive discussion of trade in services within GATT.[48]

Although the developed countries recognized the significance of trade in services, they could not yet agree on which organization would best determine and enforce the rules that would govern a multilateral trade system for services. Possible choices included the GATT, UNCTAD and OECD forums. The US preferred the GATT, while developing countries preferred UNCTAD where they possessed greater voting power compared to that of the US.

At the GATT Ministerial Meeting in Geneva in 1982, the US argued that the most important task was to establish a work programme on services to prepare the technical base for multilateral negotiations. The US however found only limited support among developed countries and outright opposition from most developing countries.[49] At that stage, other GATT members were not prepared to start negotiations on services. They lacked the necessary economic knowledge, and in consequence were unable to identify what their national interests would be in such negotiations.[50] The US, on the other hand, was the world's largest

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[47] *Ibid.*

[48] B. Hindley, "Principles in Factor-related Trade in Services" in Messerlin and Sauvant (1990), note 1, p. 25.

[49] The results of the Tokyo Round left many developing countries disappointed, and thus they were not prepared to enter into trade negotiations on services let alone on any "new subjects".

[50] John Croome, *Reshaping the World Trading System: A History of the Uruguay Round* (1995), p. 16.

exporter of services and the most advanced in data collection.[51] It was therefore not surprising that the US should be the initiator of the liberalization process of trade in services.

Despite real enthusiasm on the part of the US to revitalize the GATT with fresh ideas and initiatives to further liberalize trade, the Ministerial Declaration on Services merely recommended that each GATT Contracting Party undertake national research into trade in services, exchanging this information and considering whether multilateral action was appropriate.[52] It was for individual Contracting Parties if they so wished to conduct such research. The 1982 Geneva Declaration on Services fell far short of the US objective of a framework for multilateral negotiations in services.

3. Growth in Protectionism and Decline in the Multilateral Trading System

Its lead in the development of the services sector alone does not suffice to explain the vigorous efforts of the US in trying to introduce trade in services to the agenda of multilateral negotiations.[53] The US determination stemmed from additional factors.

One of these was the US's growing economic dependence on the rest of the world and the erosion of US dominance of the international trading system.[54] By the 1980s, both Europe and Japan had recovered from the Second World War and developed into strong economies. While the US

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51 Steven F. Benz, "Trade Liberalization and the Global Service Economy", 19 *JWTL* (1985), p. 95 at 98.

52 The Ministerial Declaration dealt with services in three short paragraphs. GATT, *Ministerial Declaration*, adopted on 29 November 1982, GATT Doc. No. L/5424.

53 In 1982, services accounted for 69 per cent of the US GNP, and 86 per cent of the job growth in the US since 1960 has occurred in the service sector. Steven Benz (1985), p. 97.

54 Joan Spero and Jeffrey Hart, *The Politics of International Economic Relations* (1997), pp. 62-71.

remained the world's largest economy and largest trading power, the rise of Europe and Japan as key players in world trade brought competition for the US. In addition, the US was experiencing declining competitiveness of its manufacturing industries and an energy crisis which resulted in increased payments to the oil exporting countries.[55] On the other hand, international trade in services was growing in importance to the US. To ensure that it did not fall behind Europe and Japan in world trade power, the US turned its energies to secure a multilateral framework of rules for trade in services. This was to provide the US with a legal system in which to guarantee the global expansion and growth of its services trade.

Second, a multilateral legal system to provide stability for the US expansion of trade in services world-wide seemed imperative when protectionism was alarmingly on the rise, even, and perhaps especially, with the conclusion of the Tokyo Round. US businesses dealing in services could not compete effectively in countries where trade-restrictive barriers applied.[56] The Office of the US Trade Representative (USTR), relying on complaints of American companies abroad, compiled a list of more than 2000 specific barriers to trade.[57] Because of the growing economic importance of the service sector, this proliferation of barriers to international trade in services was of deep concern to the US. The US

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[55] Philip H. Gold, "Legal Problems in Expanding the Scope of GATT to Include Trade in Services", 17 *The International Trade Law Journal* (1982-1983), p. 281 at 283; see also G. Feketekuty, *Next Steps in U.S. Trade Policy* (1981).

[56] Gold (1982-1983), p. 281. See also US Dept. of Commerce, *US Industries in World Markets* (1976) for a comprehensive analysis of the participation and problems of US service industries in international commerce. See also A. Sapir and E. Lutz, *Trade in Services: Economic Determinants and Development-Related Issues*, World Bank Staff Working Paper 480 (1981), p. 46 and Chapter 3 on protectionism generally.

[57] These include discriminatory practices as deliberate protectionist measures as well as legitimate ones for achieving national economic and social policy goals. P. H. Gold (1982-1993), p. 281.

sought expansion of the scope of GATT to include trade in services to reduce barriers to free trade.[58]

By the next meeting of the GATT Council of Ministers in November 1984, only thirteen national studies on trade in services, none from developing countries, had been submitted by individual GATT Contracting Parties in response to the 1982 Ministerial Declaration.[59] These studies, however, showed that a clear definition of trade in services was lacking and that trade in services data was incomplete, that heavy regulation was common in service industries, that a wide variety of trade barriers impeded trade in services, and that the importance of services required countries to reassess the role which trade in services played in the formulation of trade policy.[60] The need for a multilateral system to govern trade in services was becoming apparent to developed countries. The US and the United Kingdom specifically called for negotiations of a multilateral framework similar to the GATT for trade in services.[61]

At the 1984 Ministerial Meeting, the US suggested an establishment of a working party on trade in services. This proposal was supported by Sweden, Canada and Israel. India, joined by Argentina, Egypt and Cuba, opposed such a move. Despite the growing realization of the importance of trade in services, discussions continued on an informal basis until late 1985 when the Preparatory Committee was formed in the GATT to prepare for new multilateral negotiations to be launched in 1986.[62] The US finally

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[58] Ballassa in Messerlin and Sauvant (1990), pp. 127-131.
[59] These national studies were submitted by the US, Canada, Japan, the European Communities, the United Kingdom, West Germany, Belgium, the Netherlands, Italy, Switzerland, Denmark, Sweden and Norway. Reyna (1993), p. 2347.
[60] US International Trade Commission, 4 *International Economic Review* (1985) as cited in Reyna (1993), p. 2347.
[61] Reyna (1993), p. 2347-8; Croome (1995), p.122.
[62] The Preparatory Committee, however, only first addressed services during the third meeting held on February 25-26, 1986. GATT, *Note on the Third Meeting,* GATT Doc. No. PREP.COM(86)3, March 7, 1986, at 49.

achieved its long sought after objective when the next GATT Round was launched in Punta del Este in September 1986. This decision to undertake formal work on trade in services by the GATT was, however, subject to heated debate between the US and developing countries.[63]

III. The Uruguay Round and the GATS

The primary focus of the Uruguay Round was, like other rounds before it, improvement of the GATT. However, for the first time the discussions sought to liberalize trade in services. This section looks at the negotiating history of the GATS during the Uruguay Round in order to provide us with a background understanding into the creation of the first multilateral framework on trade in services.

1. Services on a "Separate" Track

The reality of having trade in services within the GATT Uruguay round of multilateral trade negotiations, after years of determined efforts by the US, was only made possible by the concession to have services negotiated on a "separate track" to that of goods. Up to the launching of the Round, developing countries refused to enter into discussion of how international rules might be developed for the sector, and of how trade in services might be liberalized.[64] Without this separate track, the developing countries

[63] Reyna (1993), p. 2354.
[64] Croome (1995), p. 122.

would have continued to refuse cooperation in considering services trade issues,[65] and the US might have withdrawn from the GATT altogether.[66]

A Group of Negotiations on Services (GNS) was established for negotiations on services trade, separate from the simultaneous negotiations on trade in goods.[67] The developing countries insisted on this "dual-track" arrangement to ensure that they could not be forced to trade off concessions on services simply to retain their access to developed countries' markets for goods.[68]

The Uruguay Round Declaration laid out the objectives of the service negotiations as follows:

> Negotiations in this area shall aim to establish a multilateral framework of principles and rules for trade in services, including an elaboration of possible disciplines for individual sectors, with a view to expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting economic growth of all trading partners and the development of developing countries. Such framework shall respect the policy objectives of national laws and regulations applying to services and shall take into account the work of relevant international organizations.[69]

This marked the first step in the realization of a multilateral system that would liberalize international trade in services.

2. *Why Liberalize Trade in Services: the Case of Liberalization v Protectionism*

Services in recent years have become more tradable, due to rapid technological advances, the growing importance of multinational business activities and the world-wide trend towards deregulation.[70] Consequently,

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65 Not one developing country carried out a national study of their services sector and submitted it to the GATT as suggested by the 1982 Ministerial Declaration.
66 Reyna (1993), p. 2354.
67 The GNS, like the Group of Negotiations on Goods, was to report to the Trade Negotiations Committee, the GATT's main negotiating committee. GATT, *Ministerial Declaration on the Uruguay Round, Part II* (20 September 1986).
68 Mario Kakabadse, *International Trade in Services: Prospects for Liberalization in the 1990s*, Atlantic Paper No. 64 (1987), p. 61.
69 GATT, *Ministerial Declaration on the Uruguay Round, Part II* (20 September 1986).
70 M. Kakabadse, "Trade in Services and the Uruguay Round", 19(2) *Georgia Journal of International and Comparative Law* (1989), p. 384.

the tradability of services has resulted in the growth of international trade in services. The expansion of trade in services, however, has been confronted with a variety of barriers and restrictions to trade throughout the globe.

This could be explained by the fact that the governing of service sectors has traditionally been an internal matter. For various reasons service industries are highly regulated in most countries. Even the US, as we have seen, regulated its service industries including airlines, banking and telecommunications. Liberalization of trade in services would mean the elimination of discriminatory regulatory policies. The belief is that freer trade in services, like freer trade in goods, will benefit all, developed and developing countries alike, and will ultimately increase the total world welfare.

(a) For Liberalization

The classic theory in favour of international trade is that of Ricardo's theory of "comparative advantage".[71] No two countries are exactly alike in natural resources, climate or work force. The theory of comparative advantage states that a country would export the product in which it had the greater advantage, or a comparative advantage, and import the commodity in which its advantage is less, or in which it had a comparative disadvantage. This would therefore allow each country to concentrate on

[71] David Ricardo, *The Principles of Political Economy*, first published in 1817. Ricardo had improved on Adam Smith's theory of absolute advantage. Then in the 1920s another theory, the Heckscher-Olin Theorem, emerged that revised Ricardo's theory. For further reading on international trade theories, see Adam Smith, *The Wealth of Nations* (1776); J.S. Mill, *Principles of Political Economy* (1848); Raymond Vernon, "International Investment and International Trade in the Product Cycle," *Quarterly Journal of Economics*, 1966, Vol. 80, 190; Raymond Vernon, "The Product Cycle Hypothesis in a New International Economic Environment," *Oxford Bulletin of Economic Statistics*, 1949, Vol. 41, 255.

doing what they do best and thereby maximize their income. The argument is that international trade would thus promote the efficient allocation of resources, a desirable economic objective.

The comparative advantage theory has been the standard argument for the opening of markets.[72] Through trade, there would be a sharing of resources, expertise and wealth. These exchanges would then spur on industrial and technological innovation.[73] Liberalization of trade in goods through the GATT, for instance, has resulted in economic growth world-wide, the technological advances which have seen the rise of Europe and Japan as economic powers in competition with the US, and the emergence of newly-industrialized countries (NICs). The argument is that liberalization of international trade in services would like-wise promote economic growth.[74]

Furthermore, in a market economy, which is the economic system in the majority of the world's states, private profitability is the driving force in determining the allocation of production within and between firms, sectors and countries. In addition, open markets would "encourage quality improvement and product and process innovation; reduce the scope for waste and rent-seeking; constrain the economic power of any individual actor; and ensure users of the continued availability of the relevant good

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[72] The free trade theory (classical trade theory) as espoused by Adam Smith and Ricardo was that unilateral trade liberalization would result in benefits to that country that liberalized even if other countries did not. However, there are qualifications to the classical theory, namely: passive reciprocity, aggressive reciprocity, infant industries, strategic trade policy, revenue-raising considerations, national security, and objections to free trade which include the impact of free trade on wages and employment, cultural diversity and political sovereignty. See Trebilcock and Howse, *The Regulation of International Trade* (1999) pp. 7-14.

[73] GATT, Trade Policies for a Better Future: Proposals for Action (Geneva, March 1985), p.5.

[74] For one of the first studies to suggest that concepts of comparative advantage also work for trade in services as they do for goods, see M.A. Katouzian, "The Development of the Service Sector: A New Approach," 22(3) *Oxford Economic Papers* (November, 1970), 362-82. See also Sapir and Lutz (1981).

and services".[75] Liberalization is the means that would realize the reduction and eventual elimination of restrictions in order to allow the uninhibited workings of private forces and decision-making.

This is also the case for services. Liberalization of services has led to greater choice of products and cheaper services. Take, for example, the United Kingdom. The UK's liberal policy towards the participation of foreign financial services companies in the UK has helped to maintain the UK as one of the three leading financial centres in the world.[76] In utilities such as telecommunications and energy, the UK pioneered privatization, trends that are now being followed worldwide. In the telecommunications sector, private investment has led to enormous growth in the sector and the emergence of new services.

(b) Against Liberalization

Developing countries, although most are market economies, have reasons against liberalization of trade in services. These stem from their concerns in three main areas: firstly, developing countries do not have a comparative advantage in service industries; secondly, they consider that their infant service industries need to be protected; and thirdly, that liberalization would impinge on national security and sovereignty.[77]

[75] WTO, CTS, *Economic Effects of Services Liberalization*, S/C/W/26, 7 October 1997, p.2.
[76] DTI, *Liberalising Trade in Services: A New Consultation on the World Trade Organization GATS Negotiations*, October 2002, p. 67.
[77] See Jeffrey J. Schott and Jacqueline Mazza, "Trade in Services and Developing Countries", 20 *JWTL* (1986), p. 253; A.F. Ewing, "Why Freer Trade in Services is in the Interest of Developing Countries", 19 *JWTL* (1985), p. 147; Richard Cooper, "Why liberalization meets resistance", in *The Uruguay Round: A Handbook on Multilateral Trade Negotiations* (Finger and Olechowski, eds.) (1987); Jagdish Bagwati, "Services", in Finger and Olechowski (1987). In some service areas, such as audiovisual services and educational services, developing countries also have concerns for the preservation of cultural identity.

As explained above, the theory of comparative advantage justifies trade. Today, the validity of this theory in terms of trade in goods is well established. There are arguments, however, as to whether the comparative advantage theory also works for trade in services. The developing countries especially believe that they have a comparative disadvantage in all service areas, and therefore have little to gain from liberalization of trade in services. Analyses on services reveal that many traded services are technology and capital intensive – areas where developed countries clearly have a comparative advantage.[78] Understandably, developing countries fear that liberalizing trade in services could hurt their economy badly through a surge in imports, exacerbating current account deficits, and harming their infant service industries.

Schott and Mazza, however, suggest that although comparative advantage in trade in services does seem to lie with the developed countries, this does not mean that developing countries have little to gain from liberalization.[79] The argument is that liberalizing trade in services provides improved efficiency from specialization and increased trade flows from which developing countries benefit.[80] Through liberalization of trade in services, a developing country could gain from the expertise that come with imported services and use it to develop its own service economy. It can then export those services they have strengthened. Some developing countries have in fact proven to be successful exporters of services: for

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[78] Bagwati in Finger and Olechowski (1987); A. Sapir, "North-South Issues in Trade in Services", 8 *The World Economy* (March 1985), pp. 27-41.
[79] Schott and Mazza (1986), p. 259.
[80] *Ibid.*

example, Korea in construction and engineering services,[81] Singapore in transport and financial services,[82] and India in software services.[83]

Ewing, in one of his arguments as to why freer trade in services is in the interests of developing countries, also suggests that potential benefits could accrue to developing countries due to the dynamic nature of comparative advantage.[84] He explains this in the context of the "three-stage" theory:

> To argue that developed countries still enjoy comparative advantage in most services and are losing it in more and more industries is not to revert to a three successive sectors theory of the development process or to condemn the developing countries to the lowest rung.[85]

He argues that in all three conventional sectors of agriculture, industry and services, comparative advantage is changing constantly and consequently developing countries could also achieve comparative advantage in services.[86] For instance, labour is cheaper in developing countries than developed countries. There are services that require inputs which are labour intensive, for example, hotel operations, tourist services and operations in construction and engineering services. Developing countries have a comparative advantage in some labour-intensive services. By expanding these service industries through the liberalization of trade in services developing countries would be able to exploit this advantage.[87] In fact, as UNCTAD stresses,

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[81] Sooyong Kim, "The Korean Construction Industry as Exporter of Services", 2(2) *The World Bank Economic Review* (May 1988), p. 225.
[82] Schott and Mazza (1986), p. 260.
[83] WTO, TPRB, "Trade Policy Review: India, Report by the Secretariat", WT/TPR/S/100, 22 May 2002, pp. 134-6.
[84] A.F. Ewing, (1985), p. 158.
[85] *Ibid.* See above Section I.2 on the three-stage theory.
[86] Ewing (1985), p. 158. Cf. J. Melvin, *Trade in Services: A Theoretical Analysis* (1989) where Melvin explains the "ephemeral nature" of comparative advantage in services.
[87] See Kenneth Heydon, "Developing Country Perspectives", in Messerlin and Sauvant (1990), pp. 163-164.

For many developing countries, the export of services is their only means of diversification, and the only way they can move away form excessive dependence on export of primary commodities.[88]

What about comparative advantage in telecommunications services for developing countries? It could be argued that as services infrastructures and capacity of developing countries' increase, they will be able to take advantage of the improved access opportunities the GATS provides. Therefore it is in the interests of developing countries to liberalize their telecommunications sector which, as an infrastructure, provides the backbone of the economy: developing countries will need strong and liberalized infrastructural service industries to enable them to place themselves in an advantageous and competitive position to export other services as well as goods.

Developing countries do recognize the importance of trade in services. It is precisely because they realize how crucial this is to their economy that they are determined to protect their service industries from encroachment by stronger foreign service providers and from dependence on them. They are apprehensive about the implications of liberalization of trade in services on their economies, especially on their infant service industries. The potential threat to these industries was the argument repeatedly asserted by developing countries, particularly by India and Brazil, against the liberalization of trade in services.

With many traded services such as banking, insurance and telecommunications dominated by large, multinational firms, developing

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[88] UNCTAD, *Assessment of Trade in Services of Developing Countries*, UNCTAD/ITCD/TSB/7, 26 August 1999.

countries feel their firms are at a distinct disadvantage, lacking the capital resources and the experienced personnel to compete effectively. Developing countries argue that the protection of emerging infrastructure services is necessary for the development of an internationally-competitive economy.[89] Without protection, developing countries fear their infant service industries will be severely damaged by foreign competitors. This in turn generates suspicion of the reach of foreign multinational corporations in their local economy: with infrastructure service industries damaged by foreign competition, they could end up being victims of decisions taken by multinational corporations which are effectively beyond national control.[90]

This takes us to the third main concern of developing countries about liberalization of trade in services: that opening up their service markets to foreign competition could impinge on their national security and sovereignty in three main ways.[91] First, liberalizing trade in services would mean an influx of transnational corporations into traditionally domestic sectors, such as banking, telecommunications, and health services.[92] Many developing countries lack the trained personnel and the administrative capacity effectively to regulate foreign corporations, especially if they have no experience of regulating an equivalently sized or structured firm, or of regulating certain types of enterprise (as with

[89] Schott and Mazza (1986), p. 261. Even the US and Canada used the infant industry argument to maintain a high tariff policy throughout most of the 1800s and the first half of the 1900s. Japan and South Korea also practiced heavy protectionist measures in order to strengthen their economies. Trebilcock and Howse (1999) p. 9. India especially has been using the infant industry argument since its independence. India also had one of the highest tariff structures in the world with rates around 125 to 175 per cent. Surijit S. Bhalla, "India", in Finger and Olechowski (1987), p. 191.
[90] Kakabadse (1987), p. 62.
[91] Cf. John H. Jackson, "The WTO 'Constitution' and Proposed Reforms: Seven 'Mantras' Revisited", 4(1) *JIEL* (March 2001), p. 67-78.
[92] See Surijit S. Bhalla (1987), pp. 192-195 on India's domestic policies and arguments against services trade liberalization.

insurance or transport services).[93] As foreign corporations have less at stake in the local economy, they may be less concerned with the development of the local economy than in the enlargement of the firm's profitability, and developing countries fear that they might make decisions detrimental to the national interest (e.g. exporting capital; retaining technology in-house). In addition, foreign participation in the media, arts and entertainment, for example, would have social and cultural, and even political, consequences for the local State.

Second, liberalization of trade in services could involve the removal of certain controls on foreign investment. This could impinge on the sovereignty and autonomy of smaller countries to determine the role of services in their infrastructures.[94] Foreign direct investment (FDI) is a very sensitive issue for developing countries, explained in part by the historical root of investments during colonial times, as well as by new fears of overseas enterprises' compliance with issues of labour standards or environmental requirements, for example.[95] This is understandable from the developing countries' perspective. However, foreign investment often involves the setting up of subsidiary companies for the domestic production of goods or supply of services. This often means an increase in jobs for the domestic economy and consequential stimulation of growth. Furthermore, FDI provides managerial skills, new technology and marketing networks, and much needed capital.

Third, state-owned or controlled firms would be subject to greater international competition, which over time could drive state-controlled firms out of business. Developing country policy makers would certainly

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[93] United Nations Centre on Transnational Corporations, *Transnational Corporations, Services and the Uruguay Round*, (1990), p. 17.
[94] Kakabadse (1987), p. 62.
[95] Schott and Mazza (1986), p. 262.

not want to lose the political and economic control that comes with state ownership, particularly in new, high technology sectors.[96]

It has been pointed out, however, that the fears of developing countries may have been misplaced.[97] Infrastructure and technological services play a central role in the development process.[98] Heavy protection by developing countries could mean forgoing the opportunities for the transfer of much needed technology and expertise.[99] For example, the newly industrialized countries such as Singapore and Korea have been acquiring comparative advantage in certain services as they accumulate organizational and technological skills, partly through the import of modern services.[100] The creation of a multilateral agreement on trade in services might not affect developing countries immediately, and freer trade would probably open up markets initially in the rich OECD countries.[101] In the long-run, however, liberalization of trade in services would bring economic growth and development to developing countries, and the first multilateral agreement on trade in services, the GATS, would establish the guiding rules to achieve this end.

Ten years after the WTO came into force developing countries' views on the liberalization of trade in services are changing. Developing countries now recognize the importance of liberalized services. However, they emphasize that they need time to assess the impact of liberalization

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[96] *Ibid.* See also the case of India's state-owned telecoms operators in Chapter 5 below.
[97] Kakabadse (1987), p. 62.
[98] Esohe Aghastise, "Services and the Development Process: Legal Aspects of Changing Economic Determinants", 24(5) *JWT* (1990), p. 103 at 106.
[99] See also B. Hindley, "Service Sector Protection: Considerations for Developing Countries", 2(2) *The World Bank Economic Review* (May 1988), p. 205-224 for further analyses on domestic services protection and the costs of protection to developing countries.
[100] Kakabadse (1987), p. 62
[101] Kakabadse (1987), p. 63.

and implement changes.[102] In addition, developing countries are demanding more openness on the part of developed countries for services of export interest to developing countries such as tourism and the movement of natural persons.[103] In the current GATS 2000 negotiations (now part of the Doha Round) these two issues are the focus of the developing countries' demands on the developed countries. Developed countries must also be willing to open up services supplied through the movement of natural persons if the liberalization of trade in services by developing countries is to be truly beneficial to them. The important factor in the liberalization of services for both developed and developing countries alike is the ability to "disentangle legitimate national regulations from protection".[104] The GATS provides the multilateral framework to achieve such an end.

IV. Liberalizing Trade in Services through GATS Principles

After years of negotiations, and threats by the US to pull out of the multilateral system, the first set of principles, standards and rules on trade in services were formulated in one multilateral agreement. The General Agreement on Trade in Services (GATS) is one of the greatest achievements to come out of the Uruguay Round. In creating the GATS, the Members resolve to expand trade in services under "conditions of

[102] See WTO, CTS, "Communication from Cuba, Dominican Republic, Haiti, India, Kenya, Pakistan, Peru, Uganda, Venezuela and Zimbabwe: Assessment of Trade in Services", S/CSS/W/114, 9 October 2001; WTO, CTS, *Assessment of Trade in Services: Compilation of Relevant Statements and Submissions*, S/CSS/W/104, 28 September 2001; Asoke Mukerji, "Developing Countries and the WTO: Issues of Implementation," 34(6) *JWT* (2000), p. 33 at pp. 58-64.

[103] See WTO, CTS, *Communication from India: Proposed Liberalisation of Movement of Professionals under General Agreement on Trade in Services (GATS)*, S/CSS/W/12, 24 November 2000.

[104] Ewing (1985), p. 156.

transparency and progressive liberalization".[105] The GATS is binding on all Members of the WTO.[106]

However, the WTO Secretariat correctly points out the following:

> [It] must be borne in mind that the Uruguay Round services package is only a beginning. The GATS rules are not complete, and are largely untested. The process of filling the gaps will require several more years of negotiations, and experience will no doubt show a need to improve some of the existing rules. Each government's schedule of liberalization commitments for trade in services is also only a first step, comparable not with its GATT schedule of 1994, but rather with the initial limited tariff-cutting undertaken when the GATT was launched half a century ago.[107]

The GATS consists of six parts and eight annexes. The first part is scope and definition; the second contains general obligations and disciplines; the third specific commitments;[108] the fourth provisions for progressive liberalization;[109] the fifth part is institutional provisions; and the sixth final provisions. The GATS, modelled on the GATT, consists of a three-part structure: first, broad principles, which apply to all services; second, additional agreements and annexes, which set out the rules for particular service sectors; third, schedules of commitments, which list an individual Member's commitments on market access and national treatment.[110]

However, unlike the GATT, the GATS is divided into general obligations (Part I) and specific commitments (Part II). General obligations, contained in Articles II to XV, are binding on all WTO Members. Specific

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105 GATS Preamble.
106 Article II:2 of the Marrakesh Agreement Establishing the World Trade Organization, also referred to as "The WTO Agreement". The GATS is Annex 1B of the WTO Agreement.
107 WTO, Secretariat, *Guide to the Uruguay Round Agreements* (1999), pp. 161-2. (*WTO Guide*).
108 See Section IV.2 below.
109 The GATS provisions on progressive liberalization require more negotiations on trade in services after the completion of the Uruguay Round. The goal is to take the liberalization process further by increasing the level of commitments in Members' schedules.
110 WTO Secretariat, *Understanding the WTO* (September 2003), p. 23.

commitments in the GATS, on the other hand, are individual country's commitments to open markets in specific service sectors. GATS specific commitments are in Articles XVI on market access, Article XVII on national treatment and Article XVIII on additional commitments. Specific commitments are negotiated among WTO Members and are recorded in national schedules which are attached to, and form an integral part of, the GATS.[111] In essence, a Member's schedule of commitments state how much access into that Member's market foreign service providers have for specific service sectors.

The GATS rules on specific commitments, which form the most important rules of the service agreement, give a much more sectoral focus to trade liberalization in services than for goods under the GATT because they apply only when commitments are made.[112] The scheduling of commitments by a Member is thus one of the most fundamental aspects of the liberalization of trade in services. To determine how open a Member's market is, to ascertain what commitments for which service sectors have been made and whether a Member has violated its GATS obligations, we must look to its schedule of commitments. Section IV.2 below discusses the complexity of schedules of commitments.

The GATS has as one of its main objectives the "achievement of progressively higher levels of liberalization of trade in services through successive rounds of multilateral negotiations"[113] that aim to attain the reduction of barriers to trade. However, barriers to trade in services,

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[111] GATS Article XX.
[112] WTO, *An Introduction to the GATS* (1999); George Verikios and Xiao-guang Zhang, *Global Gains from Liberalising Trade in Telecommunications and Financial Services* (October 2001), p. 3.
[113] GATS Preamble.

unlike those for goods, are mostly found within the borders of a country and take the form of domestic regulations. This makes it difficult to identify restrictions to trade in services and as a result, constructing the GATS itself has been a particularly complicated task.[114] In addition, services can be traded through four different types of supply, not just by crossing the border like trade in goods. Furthermore, governments generally regulate their service sectors more than they do manufacturing, so that domestic regulations often limit trade even if they do not explicitly discriminate against foreign providers. All these factors add to the difficulty in creating an international agreement for the liberalization of trade in services. By adopting the framework, rules and principles of the GATT, albeit adapted to meet the challenges posed by the complexities of trade in services, the architecture of the GATS is flawed.[115]

The WTO rules that affect Members' commitments on trade in telecommunications services are to be found in the GATS, the Annex on Telecommunications and the Fourth Protocol along with the attached schedules of commitments and they will be discussed in the next chapter. But first, we turn to consider the scope of the GATS and the definition of trade in services.

1. *Scope and Definition of Trade in Services*

GATS Article I:1 states:

This Agreement applies to measures by Members affecting trade in services.

[114] Geza Feketekuty, "Assessing and Improving the Architecture of GATS", in Sauvé and Stern, eds., *GATS 2000: New Directions in Services Trade Liberalization* (2000), p. 90.
[115] *Ibid.*, p. 92.

It has been held that this provision gives the GATS a "broad reach" as any measure that has "an effect on" trade in services is covered by the provisions of the GATS.[116]

We briefly examined the definition of services earlier on in section I.1 of this chapter. Services are intangible and mostly non-storable, and often require interaction between the user and the provider of the service. Moreover, any given service is continuously changing in content and characteristics due to technological advances. This is why the drafters of the GATS concluded that no practical purpose could be served by an attempt to define "services".[117] Instead the GATS, in Article I:2, contains a definition of *trade* in services:

For the purposes of this Agreement, trade in services is defined as the supply of a service:

(a) from the territory of one Member into the territory of any other Member;
(b) in the territory of one Member to the service consumer of any other Member;
(c) by a service supplier of one Member, through commercial presence in the territory of any other Member;
(d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.[118]

This definition of trade in services formulates four different modes of supply: cross-border (mode 1),[119] consumption abroad (mode 2),[120] commercial presence in the consuming country (mode 3),[121] and presence of natural persons (as service providers in the consuming country) (mode

[116] WTO, Appellate Body, *European Communities – Regime for the Importation, Sale and Distribution of Banana* WT/DS27/AB/R, para. 220; see also Panel Report (WT/DS27/R/ECU, WT/DS27/R/GTM, WT/DS27/R/HND, WT/DS27/R/MEX, WT/DS27/R/USA), paras. 7.280 and 7.285; both reports adopted 25 September 1997. (*EC-Bananas*).
[117] Aly Abu-Akeel, "Definition of Trade in Services under the GATS: Legal Implications", 32(2) *The George Washington Journal of International Law and Economics* (1999), p. 189 at 190; see also GATT, GNS, *Note on the Meeting of 23-25 October 1989*, MTN.GNS/26, 17 November 1989, para. 86.
[118] GATS Article I:2.
[119] GATS Article I:2(a).
[120] GATS Article I:2(b).
[121] GATS Article I:2(c).

4).[122] In defining trade in services through modes of supply, the GATS covers all services and thus takes account of any new form of services that might arise in the future. Although this approach of defining trade in services into four modes is useful for analytical purposes, it has, however, made the listing of commitments more complex than necessary. This difficulty is apparent in the scheduling of market access and national treatment commitments which we examine below and in the next chapter when we look at the WTO dispute settlement case of *Mexico – Telecommunications.*[123]

The first mode of delivery of services, cross-border trade, is the most straightforward, and it corresponds to the normal form of trade in goods. Examples of cross-border services are services supplied through telecommunications or mail, for instance banking services transmitted via such means.[124] The supply of services through the first mode does not require either the supplier or the consumer to travel to one another in order for trade of such service to take place. Although normally straightforward, this mode of delivery has proved a subject of contentious arguments between Mexico and the US in *Mexico – Telecommunications.*[125]

The second mode of supplying services, consumption abroad, covers situations where a service consumer or his property moves into another Member's territory to obtain a service (e.g. tourism, attending an educational establishment abroad or ship repair abroad).[126] Like cross-

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122 GATS Article I:2(d).

123 WTO, *Mexico – Measures Affecting Telecommunications Services,* Panel Report, WT/DS204/R, adopted 1 June 2004. (*Mexico-Telecommunications*).

124 WTO, *Guidelines for the Scheduling of Specific Commitments under the GATS,* adopted by the Council for Trade in Services on 23 March 2001, S/L/92, p. 9, para. 28. (*Scheduling Guidelines*).

125 *Mexico-Telecommunications,* Panel Report; and see Chapter 4.

126 *Scheduling Guidelines,* para. 29.

border supply, consumption abroad is a straightforward form of trade where the service supplier does not need to be admitted to the consuming country. The bindings undertaken for this mode are thus considerably more liberal than those for the other three modes, with 50% of market access entries being marked without limitations.[127]

Commercial presence, the third mode of delivery, means:

> any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service.[128]

This is probably the most important mode of supply of services in terms of future development, as well as raising the most difficult issues for host governments and GATS negotiators.[129] Examples of this mode of service supply are hotel chains, insurance companies and telecommunications providers. Trade in services through commercial presence is closely related to FDI and may overlap with it. Thus, bearing in mind the developing countries' sensitiveness to FDI,[130] trade in services through commercial presence raises many issues and concerns for them.

The fourth mode, the supply of services through the presence of natural persons (i.e. the admission of foreign nationals to another country to provide services there), can assume two forms under the GATS.[131] The first relates to the situation where a mode 3 foreign supplier employs some foreign staff, such as foreign managers or specialist or engineer to the foreign branch from the parent company. The second form relates to the

[127] WTO, *Market Access: Unfinished Business*, Special Studies 6 (2002), p. 4.
[128] GATS Article XXVIII(d).
[129] WTO, *An Introduction to the GATS* (1999), p. 3.
[130] See above Section III.2(b).
[131] P. Chang, G. Karsenty, A. Mattoo and J. Richtering, "GATS, the Modes of Supply and Statistics on Trade in Services", 33 (3) *JWTL* (1999), p. 93 at 96.

presence of foreign natural persons independently of foreign commercial presence. This could involve independent persons who are themselves service suppliers and present on a temporary basis in foreign markets for the supply of their services, such as foreign consultants, or employees of a foreign service supplier. The bindings on mode 4 services are the least liberal of the four.

Compared to trade in goods, the definition for trade in services is broader as it encompasses not only cross-border trade but also movement of natural persons. This comprehensive definition of trade in services is intended in order for the GATS to apply in principle to *all* services, except those supplied in the exercise of governmental authority.[132] Trade in services will mostly be in the forms of cross-border supply and supply through commercial presence. These are the two main forms of how telecommunications services are traded.

A salient feature of trade in services is that,

> Unlike market access for shipment of goods going from one country to another, which is principally a matter of customs duties and other formalities at the border, the ability to provide a service to another country depends on government regulations that may be quite different for one of the four modes of supply than for another.[133]

Consequently, the precise scheduling of market access and national treatment commitments in a Member's services schedule is crucial to the extent of market liberalization of trade in services, including telecommunications services.

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[132] GATS Article I:3(b) states: ' "services" includes any service in any sector except services supplied in the exercise of governmental authority.' And '"a service supplied in the exercise of governmental authority" means any service which is supplied neither on a commercial basis nor in competition with one or more service suppliers'. GATS Article I:3(c).
[133] *WTO Guide* (1999), p. 165.

2. The Scheduling of Commitments

The specific commitments are listed in national "schedules of commitments" that detail the service sectors being opened, the extent of market access given in those sectors, and any limitations on national treatment. By virtue of Article XX of the GATS, every signatory must attach to the GATS its national schedule. Any commitment can be modified or withdrawn "at any time after three years have elapsed from the date on which that commitment entered into force".[134] Nonetheless, the modifying Member must enter into negotiations with affected countries, if the latter so request, with a view to reaching an agreement on any necessary compensatory adjustments.[135]

Services schedules are complex, and very different from GATT schedules.[136] A GATS schedule has four columns. The first column contains the classification of services which are broken down into sectors and sub-sectors. According to the WTO, there are twelve categories of services sectors that could be listed in a schedule: business (including profession and computer) services; communication services; construction and related engineering services; distribution services; educational services; financial (insurance and banking) services; health-related and social services; tourism and travel-related services; recreational, cultural and sporting services; transport services; and other services not included

[134] GATS Article XXI:1(a).
[135] GATS Article XXI:2(a).
[136] A GATT schedule, known as "schedule of concessions", consists of a long list of numbers identifying different products and specifying a Member's binding commitments on tariffs for goods – a maximum import duty chargeable on each listed product – and quotas for some agricultural goods.

elsewhere.[137] It is up to each Member to decide which service sectors it wishes to open up to foreign suppliers: listing a service sector in its schedule indicates the Member is legally bound in that service sector. Thus, unlike the GATT schedule, the GATS scheduling of sectors adopts a "positive-list" approach.

The second column is the market access column, and the third column is for national treatment. Under the market access and national treatment columns, Members inscribe their commitments as broken down into the four modes of delivery of a service (cross border, consumption abroad, commercial presence and movement of natural persons). Scheduling "none" against a mode of supply means there are no limitations to market access or national treatment that apply to that mode: the Member undertakes full commitments to market access or national treatment to that particular mode. Scheduling "unbound" against a mode of supply means that the Member has undertaken no commitments in that particular mode of supply, and the Member remains free to introduce restrictions. If a measure is inconsistent with both market access (Article XVI GATS) and national treatment (Article XVII GATS), it should be inscribed in the market access column. In such a case, the inscription will be considered to provide a condition or qualification to Article XVII as well.[138] The scheduling of market access and national treatment commitments has proved very complicated and confusing for many WTO Members, particularly developing-country Members.

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[137] WTO, *Services Sectoral Classification List*, Note by the Secretariat, MTN.GNS/W/120, 10 July 1991. The telecommunications services sub-sector is listed under the communications services sector as sub-sector 2.C.
[138] GATS Article XX:2.

The last column is additional commitments, where Members list any further commitments not covered by the market access and national treatment provisions. Additional commitments, expressed in the form of "undertakings", not limitations, could include, but are not limited to, undertakings with respect to technical standards, licensing requirements and other domestic regulations that are consistent with Article XVI.[139] An example of additional commitments which has contributed to the liberalization process of a services sector is the "Reference Paper" on basic telecommunications.[140] Thus, GATS scheduling adopts a "hybrid" approach: a positive list approach for the sector column and additional commitments column, and a negative list approach for market access and national treatment columns.

The importance of scheduling services commitments as extensively, precisely and clearly as possible is imperative to the liberalization of trade in services. In the next Chapter we will examine the first WTO dispute settlement case on telecommunications services, which hinges on the interpretation of Mexico's Schedule of Commitments.

The liberalization of trade in services, including telecommunications services, is achieved through sectoral liberalization, through specific commitments on market access and national treatment, and through the general obligations in Part II of the GATS.

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139 GATS Article XVIII; *Scheduling Guidelines*, para. 19.
140 See Chapter 4.

3. *GATS Rules and Principles*

There are five fundamental principles that form the foundation of the multilateral trading system, and of the main agreements of the WTO, including the GATS.[141] These include:[142]

(i) non-discrimination between trading partners (MFN principle);[143]

(ii) non-discrimination between foreign and domestic products, service suppliers, and trademarks (national treatment);[144]

(iii) freer trade through reduction of barriers,[145] binding of commitments and greater transparency;[146]

(iv) promotion of competition through rules on non-discrimination, anti-dumping and subsidies;[147] and

(v) encouragement of economic reform and development through greater accommodation of the needs of developing and particularly least-developed countries.[148]

The two major non-discrimination principles of most-favoured-nation (MFN) and national treatment remain at the heart of the international trading system for trade in services as for trade in goods. In addition, GATS provisions on market access, domestic regulation and transparency complete the general framework for the liberalization of trade in services. We examine these GATS provisions below and discuss the dispute

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141 WTO, *Understanding the WTO* (September 2003), pp. 10-13. The other two agreements are the GATT and the TRIPS (Agreement on Trade-Related Aspects of Intellectual Property Rights).

142 See WTO, *Understanding the WTO* (2003), pp. 10-13.

143 GATS Article II.

144 GATS Article XVII.

145 GATS Articles VI, XVI-XXI.

146 GATS Articles III, VI, VIII, XVI-XVIII, XX-XXI.

147 GATS Articles II, VIII, XV.

148 GATS Articles IV, XIX, XXV.

settlement cases brought before the WTO Panel and the Appellate Body and the legal reasoning and interpretations delivered in relation to the GATS. Since the creation of the WTO, there have only been four cases[149] that resulted in reported rulings on GATS provisions by the dispute bodies.

4. *Most-favoured-nation Treatment*

The MFN principle has been the standard used under the multilateral trading system of the GATT 1947 to liberalize trade in goods for more than fifty years, and remains the foundation of the multilateral trading system of the WTO. The importance of the MFN non-discrimination principle lies in the historical purpose of the GATT to replace a proliferation of bilateral trade agreements with a multilateral one. It applies not only to goods, but also to services and intellectual property.

The MFN treatment as found in GATT 1994, and in GATT 1947, is unconditional.[150] What this means is that each contracting state is obliged to treat all other contracting states similarly. This is set out in Article I of the GATT as follows:

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[149] *European Communities – Regime for the Importation, Sale and Distribution of Banana*, Panel Report (WT/DS27/R/ECU, WT/DS27/R/GTM, WT/DS27/R/HND, WT/DS27/R/MEX, WT/DS27/R/USA), and Appellate Body Report (WT/DS27/AB/R), adopted 25 September 1997 (*EC-Bananas*); *Canada – Certain Measures Affecting the Automotive Industry*, Panel Report, WT/DS139/R, WT/DS142/R, and Appellate Body Report, WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000 (*Canada-Automotive*); *Mexico-Telecommunications*, WT/DS204/R, adopted 1 June 2004 (although the Panel considered the GATS Annex on Telecommunications, it was not required to examine any of the substantive provisions in the main GATS); and *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, Report of the Panel, WT/DS285/R, released 10 November 2004 (not yet adopted - US appealed to the Appellate Body on 7 January 2005 (WT/DS285/6, 13 January 2005)), (*US-Gambling*).

[150] For an argument in favour of a conditional MFN for the GATS, see Tycho H.E. Stahl, "Liberalizing International Trade in Services: The Case for Sidestepping the GATT," *The Yale Journal of International Law*, Vol. 19, 1994, p. 405.

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III,* any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.[151]

MFN treatment under the GATT implies that a Member is not permitted to grant any advantage to a product of a third country, whether a WTO Member or a non-Member, without according the same advantage to a *like* product of another WTO Member. If the product in question is *not* a "like" product, there is no violation of the most-favoured-nation treatment obligation under GATT Article I. Thus, the determination of "like" products is crucial to ascertaining a Member's obligation under the GATT MFN. There is however no definition of "like product" in either GATT 1947 or GATT 1994. The Panel therefore has had to determine the issue of "like product" on a case-by-case basis.[152]

The concept of like products appears in other provisions of the GATT 1994, such as Article III paragraphs 2 and 4 on national treatment. It is agreed, however, that the term "like product" should not necessarily be interpreted in the same way in each of these provisions.[153] The Panel and the Appellate Body reiterated this in the case of *Japan – Taxes on Alcoholic Beverages*:

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[151] Article I:1 of GATT 1994.
[152] See GATT, Panel Report, *Spain – Tariff Treatment of Unroasted Coffee,* adopted on 11 June 1981, BISD 102 (1982); GATT, Panel Report, *Japan – Tariff on Import of Spruce-Pine-Fir (SPF) Dimension Lumber,* adopted on 19 July 1989, BISD 167 (1990), (*Japan-Dimension Lumber*).
[153] WTO, WGTCP, "The Fundamental WTO Principles of National Treatment, Most-Favoured-Nation Treatment and Transparency", WT/WGTCP/W/114, 14 April 1999, para. 48.

> The term "like product" appears in various GATT provisions. The Panel [...] noted that it did not necessarily follow that the term had to be interpreted in a uniform way.[154]

This, however, leaves open the question of how the meaning of the term should vary from clause to clause. It has been suggested that in terms of the MFN, the term "like product" should be construed broadly "so as to strike down discriminatory measures wherever possible."[155] However, it would seem that GATT panels have tended to adopt a narrow approach to the term under GATT Article I with regard to tariff issues.[156]

In the GATS, the MFN treatment principle is set out in Article II:1 as follows:

> With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.

The concept of "like products" in the GATS is in the form of "like services and service suppliers".[157] The concept of "like services and service supplier" is even more difficult to identify and define than GATT "like products". Services can be delivered in four ways, while "service supplier" is defined as any person that supplies a service.[158] Furthermore, "person" means either a natural person or juridical person,[159] and "supply of a service" includes the production, distribution, marketing, sale and delivery

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154 *Japan – Taxes on Alcoholic Beverages*, Panel Report (WT/DS8/R, WT/DS10/R, WT/DS11/R), para. 6.20; Appellate Body Report, (WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R), adopted 1 November 1996, p. 20. (*Japan-Alcoholic Beverages*).
155 Jackson, Davey, and Sykes, *Legal Problems of International Economic Relations* (1995), p. 449.
156 *Japan-Dimension Lumber.*
157 GATS Article II and GATS Article XVII.
158 GATS Article XXVIII(g).
159 GATS Article XXVIII(j).

of a service.[160] There are thus more layers in trying to determine "like services and like service suppliers" than for that of "like products".[161]

"Like services and service suppliers" was first considered by the Panel in *EC – Bananas*.[162] The case against the EC was brought before the WTO Panel by Ecuador, Guatemala, Honduras, Mexico, and the US alleging that the EC's banana import regime and licensing procedures for the importation of bananas in the regime were inconsistent with its obligations under GATT 1994 and the GATS. The issue of "like services and service suppliers" involved wholesale trade services, in this case of bananas, and the Panel first determined this with regard to the national treatment principle in GATS Article XVII. Surprisingly, the Panel dedicated little attention, and at best provided "summary reasoning", to this important issue.[163] The Panel stated:

> ... in our view, the nature and the characteristics of wholesale transactions as such, as well as of each of the different subordinated services mentioned in the headnote to section 6 of the CPC, are "like" when supplied in connection with wholesale services, irrespective of whether these services are supplied with respect to bananas of EC and traditional ACP origin, on the one hand, or with respect to bananas of third-country or non-traditional ACP origin, on the other. Indeed, it seems that each of the different service activities taken individually is virtually the same and can only be distinguished by reference to the origin of the bananas in respect of which the service activity is being performed. Similarly, in our view, *to the extent that entities provide these like services, they are like service suppliers.*[164]

This analysis of "like services and suppliers" was then applied to GATS Article II.[165] Thus, the Panel in *EC-Bananas* used the same

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160 GATS Article XXVIII(b).
161 See Nicolaïdis and Trachtman in Sauvé and Stern (2000), pp. 252-255, where they ask the question: what makes two services like? Is Internet telephony, for example, "like" standard telephone service? More fundamentally, is it permissible to make distinctions between services on the basis of the identity and structure of the service supplier as well as the way the service appears to the consumer? Nicolaïdis and Trachtman indicate that there is a distinction between services and service providers. Another distinction is between mode 1 supply (which occurs outside the importing state) and mode 3 supply (which occurs within the importing state).
162 Panel and Appellate Body Reports, adopted 25 September 1997.
163 Werner Zdouc, "WTO Dispute Settlement Practice Relating to the GATS", 2 *JIEL* (1999), p.295 at 331.
164 *EC-Bananas*, Panel Report, WT/DS27/R/USA, para. 7.322. (Emphasis added).
165 *EC-Bananas*, Panel Report, para. 7.346.

interpretation of "like services" for the two different provisions of Article II and XVII in the GATS. The Appellate Body did not add further to the Panel's interpretation.

In a second and only other WTO dispute case to date where the Panel and Appellate Body had to interpret "like services" is *Canada – Certain Measures Affecting the Automotive Industry.*[166] In this case, Japan and the EC brought a case to the WTO alleging that Canada's legislation implementing an automotive products agreement between the US and Canada violated GATT 1994 and the GATS. More specifically, the parties contended that under this legislation only a limited number of motor vehicle manufacturers were eligible to import vehicles into Canada duty free and to distribute the vehicles in Canada at wholesale and resale distribution levels. This duty-free treatment is contingent upon two requirements: 1) a Canadian value-added (CVA) content requirement that applies to both goods and services, and 2) a manufacturing and sales requirement. With regard to the GATS, the parties alleged that the measures were inconsistent with Articles II, VI and XVII.

Once again, little attention was given to this issue of "like services". The Panel held:

> The complainants argue, and Canada does not contest, that manufacturer beneficiaries and non-manufacturer-beneficiaries provide "like" services and are "like" service suppliers, irrespective of whether their services are supplied with respect to motor vehicles imported by the manufacturer beneficiaries or with respect to motor vehicles imported by non-manufacturer-beneficiaries, and regardless of whether or not they have production facilities in Canada ... We agree that to the extent that the service suppliers concerned supply the same services, they should be considered "like" for the purpose of this case.[167]

One reason why the Panels and Appellate Body in both *EC-Bananas* and *Canada-Automotive* dedicated little consideration to analyzing "like

[166] *Canada-Automotive*, Panel and Appellate Body Reports.
[167] *Canada-Automotive*, Panel Report, para. 10.247.

services and suppliers" was the fact that the Parties to the disputes themselves did not concentrate on this issue. As can be seen from the above quote, for example, Canada did not contest the complainants' assertion that the manufacturers in question were like service suppliers.

A second element of the GATS MFN is the "treatment no less favourable" standard, similar to that found in the GATT and GATS national treatment provisions, but which is not also found in GATT MFN. In *EC-Bananas* the Panel encountered this problem of interpreting "treatment no less favourable" in the GATS MFN clause.

The Panel in interpreting "treatment no less favourable" in GATS Article II:1 referred to GATS Article XVII (national treatment), as the latter contains the same wordings "treatment no less favourable" and in addition provides in its second and third paragraphs clarification as to how Members may ensure non-discrimination.[168] Such clarification is not provided in GATS Article II. The Appellate Body, however, criticized this reasoning of the Panel:

> Article II of the GATS relates to MFN treatment, not to national treatment ... The Panel would have been on safer ground had it compared the MFN obligation in Article II of the GATS with the MFN and MFN-type obligations in the GATT 1994.[169]

The Appellate Body itself, however, did not explain why it should be more appropriate to interpret the MFN clause of GATS Article II along the lines of the differently worded MFN treatment clause of GATT Article I.[170] It did not even provide a sufficient break down in its interpretation of "treatment no less favourable" in GATS Article II. The Appellate Body merely stated that,

168 *EC-Bananas*, Panel Report, para. 7.301.
169 *EC-Bananas*, AB Report, para. 231.
170 Zdouc (1999), p. 345.

The GATS negotiators chose to use different language in Article II and Article XVII of the GATS in expressing the obligation to provide "treatment no less favourable" [...] The possibility that the two Articles may not have exactly the same meaning does *not* imply that the intention of the drafters of the GATS was that a *de jure*, or formal, standard should apply in Article II of the GATS [...] The obligation imposed by Article II is unqualified. The ordinary meaning of this provision does not exclude *de facto* discrimination.[171]

Thus, the Appellate Body held that "'treatment no less favourable' in Article II:1 of the GATS should be interpreted to include *de facto*, as well as *de jure*, discrimination".[172] The Appellate Body nonetheless came to the same conclusion as the Panel – that the EC's various licensing measures were inconsistent with Articles II and XVII of the GATS.

Another case where the Appellate Body was asked to review the Panel's findings on the MFN obligation in the GATS is *Canada-Automotive*.[173] The Panel found that the manner in which Canada conditioned access to the import duty exemption was inconsistent with the MFN obligation of GATS Article II:1. The Appellate Body, however, reversed this finding due to the error made by the Panel in its legal analysis leading to this conclusion.

In its reasoning, the Appellate Body established a procedure whereby the consistency of a measure with GATS Article II:1 should be analyzed:

First, a threshold determination must be made under Article I:1 that the measure is covered by the GATS. This determination requires that there be "trade in services" in one of the four modes of supply, and that there be also a measure which "affects" this trade in services. If the threshold determination is that the measure *is* covered by the GATS, appraisal of the consistency of the measure with the requirements of Article II:1 is the next step. The text of Article II:1 requires, in essence, that treatment by one Member of "services and service suppliers" of any other Member be compared with treatment of "like" services and service suppliers of "any other country". Based on these core legal elements, the Panel should first have rendered its interpretation of Article II:1.[174]

[171] *EC-Bananas*, AB Report, para. 233.
[172] *EC-Bananas*, AB Report, para. 234.
[173] *Canada-Automotive*, Panel Report and Appellate Body Report.
[174] *Canada-Automotive*, AB Report, paras. 170-171.

And applying this analysis to the case before it, the Appellate Body stated:

> [The Panel] should then have made the factual findings as to treatment of wholesale trade services and service suppliers of motor vehicles of different Members commercially present in Canada. Finally, the Panel should have applied its interpretation of Article II:1 to the facts as it found them. The Panel did none of this.[175]

Reversing the Panel's finding, the Appellate Body concluded:

> In reaching its conclusions under Article II:1 of the GATS, the Panel has neither assessed the relevant facts [...] nor has it interpreted Article II of the GATS and applied that interpretation to the facts it found.[176]

Despite having set out the steps to be taken in analyzing a measure's consistency with the GATS MFN obligation and addressing the fact that "claims made under the GATS deserve close attention and serious analysis", the Appellate Body did not apply its suggestions to the case but instead declared that they were to "leave interpretation of Article II of the GATS to another case and another day."[177]

Because the liberalization of trade in services in the WTO functions through the provisions of the GATS, and the MFN treatment is one of its core principles it is imperative that the interpretation of the MFN clause of GATS Article II:1 be clarified in future dispute settlement cases. This might take time, however, due to the complexity of the nature of trade in services and the newness of the obligations. As seen above, the problems of interpreting the MFN treatment in the GATS arise from the fact that it is parallel to the MFN provision as found in Article I:1 of the GATT but is worded differently due to the various differences in the nature of trade in services from that of trade in goods. The GATS MFN obligation, therefore,

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[175] *Canada-Automotive*, AB Report, paras. 171-172.
[176] *Canada-Automotive*, AB Report, para. 181.
[177] *Ibid.*, para. 184.

cannot be applied in identical fashion to that applied in the GATT. In contrast to the GATT, the GATS MFN principle does not have tariffs or any other form of direct taxation of goods as its focal point.

The MFN obligation in GATS Article II:1 is broad in nature and includes all measures affecting trade in services.[178] There are, however, some exceptions and exemptions to the general and unconditional GATS MFN obligation. MFN treatment for trade in services is qualified by GATS Article II:2, which permits Members to maintain measures inconsistent with Article II:1 as long as such measures are listed in and meet the conditions of the Annex on Article II Exemptions.[179] The Annex on Article II Exemptions gave Members a once only opportunity to list measures inconsistent with the MFN obligation before the GATS entered into force. After that date, any new exemptions are to be dealt with through the more stringent procedures for waivers provided in Article IX of the WTO Agreement. These exemptions are subject to review by the Council for Trade in Services, and not to last more than ten years.[180]

In any case, all the commitments set out in a country's schedule have to be fulfilled on an MFN basis. The MFN exemption can only be used to grant *more* favourable treatment than that provided for in the schedule of specific commitments and only to the Members or countries specified in the exemption. The inclusion of exceptions and exemptions in the GATS were necessary to get Member countries to accept a general obligation of an unconditional MFN clause that bound them to provide MFN treatment to every measure concerning trade in services, and not just

[178] Aly Abu-Akeel, "The MFN as it Applies to Service Trade: New Problems for an Old Concept", 33(4) *JWT* (1999), p. 103 at 128.
[179] GATS Article II:2.
[180] This one-off opportunity is also available to new Member countries on their accession to the WTO.

measures in certain service sectors. During the Uruguay Round, it was agreed that liberalization of trade in services subject to some temporary MFN exceptions would be preferable to no liberalization at all.[181]

As a general obligation, the MFN principle encourages progressive liberalization of trade in services through non-discrimination treatment between WTO trading partners in regard to any service in any sector. With regard to telecommunications, the MFN obligation is particularly relevant and important to the international system of settlement rates. At the end of the Uruguay Round and the Negotiations on Basic Telecommunications, Members agreed in a "gentleman's agreement" that the international accounting rate system is excluded, for now, from the GATS MFN obligation.[182] The subject of this moratorium on accounting rates is currently being discussed in the GATS 2000 (Doha Round) negotiations.

5. *National Treatment Principle*

The core of the national treatment principle is that foreign products, services or service suppliers should not be discriminated against in regards to opportunities to compete with like domestic products or services. Unlike the MFN obligation in the GATS and unlike its GATT national treatment counterpart, the GATS national treatment principle is not a general obligation. Instead, national treatment under GATS Article XVII is a specific commitment and therefore applies only to the service sectors inscribed in individual Member's schedule of commitments.[183] This is in part due to the fact that for trade in services it is generally more

[181] WTO, *An Introduction to the GATS* (1999), p. 4.
[182] See WTO, GBT, S/GBT/4, 15 February 1997.
[183] GATS Article XVII. On the scheduling of commitments, see above Section IV.2.

difficult to make a distinction between border measures and internal measures, and thus making it more difficult to determine when national treatment obligation should come into play.[184] In the case of services, there are few measures which are applied at the "border", and most restrictions arise from internal measures. The national treatment obligation as found in the GATS is therefore somewhat different to the GATT national treatment.

The first noticeable difference is the briefness in the GATS national treatment provision, compared to the GATT. A more significant distinction is that the GATS provision is wider in scope than the GATT but is more limited in its application.[185] It is wider in scope because, whereas the GATT national treatment obligation is concerned only with measures affecting products *per se*, and not the treatment of persons of other Members, the GATS national treatment includes measures affecting services *and* service *suppliers* of other Members. In addition, GATS national treatment covers *all* measures *affecting* the supply of services and not just internal measures as in the GATT.[186] However, as seen above, the GATS national treatment is limited in application because it applies only to scheduled service sectors, and not to all services. Members have the freedom to tailor the extent of their commitments on services.[187]

This application of national treatment only to those scheduled service sectors limits the liberalizing effect of the national treatment principle to trade in services. The reason lies once again in the nature of trade in

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184 For trade in goods, border measures would be subject primarily to the disciplines of Article II (MFN) and Article XI (General Elimination of Quantitative Restrictions) of the GATT, while internal measures would be dealt with by the national treatment obligation of GATT Article III.
185 Aaditya Mattoo, "National Treatment in the GATS: Corner-stone or Pandora's Box", 31(1) *JWT* (1997), p. 107 at 107.
186 GATS Article XVII:1.
187 WTO, Secretariat (Trade in Services Division), "The GATS: Objectives, Coverage and Disciplines", October 1999, p. 4.

services. There are four different modes of supplying services, and the means for regulating vary widely between modes. The complexity of trade in services and their close involvement in domestic regulation led states to conclude during the Uruguay Round that a general obligation for national treatment for trade in services on the same lines as that for trade in goods would not be appropriate. Essentially, the negotiators decided to exercise restraint in the liberalization of trade in services through the national treatment principle which they believed could impinge upon a state's right to regulate domestic services.[188]

There are three main elements to GATS national treatment. First, as stated above, GATS national treatment applies only to service sectors inscribed in a Member's schedule. Second, GATS national treatment applies to all measures affecting the supply of services. Third, national treatment in the GATS means that treatment no less favourable must be accorded to foreign services and service suppliers as those accorded to its own like services and service suppliers.[189]

In *EC-Bananas* the Panel for the first time considered the GATS national treatment principle. The Panel set out to determine the consistency of the EC's measures at issue in the case using the three steps as in the above paragraph. The Panel found that the EC did make commitments on national treatment with regard to the services at issue (first element), and that the EC measures were measures "affecting the supply of services" at issue in the case (second element).[190] To determine the third element, there are two criteria to address: 1) like services and

188 The GATS Preamble states that the WTO recognizes "the right of Members to regulate, and introduce new regulations, on the supply of services within their territories in order to meet national policy objectives".
189 See also *EC-Bananas*, Panel Report, para. 7.314.
190 *EC-Bananas*, Panel Report, paras. 7.315-7.316.

service suppliers; and 2) treatment no less favourable. We consider these two important criteria in turn.

As already discussed in the previous section on MFN, in *EC-Bananas*, both the Panel and the Appellate Body gave little attention to interpreting the concept of "like services", and the same interpretation of like services was applied by the Panel for both the MFN and national treatment provisions.[191] In the second case on services, *Canada-Automotive*, the Panel also dealt with the issue of "likeness" briefly and without setting out a systematic guideline as to how this legal point should be determined in future cases.[192] The Panel held, but restricted to the purposes of the case before it, that services supplied through different modes can be "like" services. In this case, services supplied in Canada through modes 3 and 4 are "like" services to those supplied from the territory of other Members through modes 1 and 2.[193]

In GATT jurisprudence, the Panel in *Japan – Alcoholic Beverages* emphasized that whether two products are "like products" should be evaluated on a case-by-case basis, taking into account the GATT provision involved. The Panel noted that various criteria had been used in the past to determine likeness. In the case before them, the Panel considered that the term "like product" should be interpreted narrowly in respect of its use in Article III:2, first sentence, because of the relationship between Articles II and III and because Article III:2, second sentence, was applicable in cases involving directly competitive or substitutable products.[194]

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191 See above Section IV.4.
192 See *Canada-Automotive*, Panel Report para. 10.289.
193 *Canada-Automotive*, Panel Report, para. 10.307.
194 *Japan-Alcoholic Beverages*, Panel Report, para. 6.21

Accordingly, the Panel concluded that like products should have common end-uses and essentially the same physical characteristics.[195] This could be determined by examining relevant factors such as the product's end-use in a given market, consumer's tastes and habits, and the product's properties, nature and quality.[196] All in all, the central problem of determining "like products" has never been solved on a general basis within GATT. The GATT and WTO dispute systems, having resolved to use the case-by-case analysis, have thus not been able to provide a predictable and consistent approach to determining when two products are "like".

The problem in the interpretation of GATS Article XVII issue of "likeness" is that, in contrast to GATT Article III,[197] GATS Article XVII does not refer to "directly competitive or substitutable" services but only to "like" services and service suppliers. In this respect, GATS Article XVII is similar to GATT Article III:4.

There is still a long way to go before GATS Article XVII can be tackled in such a way as to provide a clear definition of "like" services and service suppliers or at least guidelines as to its scope. A good starting point would be to refer to the "Services Sectoral Classification List".[198] The list is intended to help classify the different existing types of services. In determining "like services and service suppliers" we first identify into which sector or sub-sector the service falls under. Then we look at the characteristics of the service. In *EC-Bananas*, for example, the characteristics of wholesale trade services include such activities as sorting, redistributing, delivering or promoting (the bananas in this case).

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[195] *Ibid.*, para. 6.22.
[196] *Ibid.*
[197] Ad Article III(paragraph 2) in Annex I of GATT 1994.
[198] MTN.GNS/W/120, 10 July 1991. See also Section IV.2 above.

It is hard to imagine how these transactions could be different in any significant way simply because the bananas with respect to which they are being supplied are of different origin.[199] Hence, the Panel's conclusion that the wholesale services supplied in that case were "like services".[200] After determining that services are like, suppliers that provide "like services" are therefore "like service suppliers".

It thus remains that in order to determine what are "like services and service suppliers", the interpretation must be made on a case-by-case basis. As the Appellate Body in *Japan – Alcoholic Beverages* stated:

> There can be no precise and absolute definition of what is "like". The concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the *WTO Agreement* are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which the provision apply.[201]

Perhaps the Council for Trade in Services could provide some clear guidance as to which criteria, factors and characteristics should serve as a basis for a determination of "likeness". It appears, however, that this is not on the agenda of the GATS 2000 negotiations.

The second important criterion to the GATS national treatment obligation is the standard of "treatment no less favourable". The GATS national treatment provision, unlike the GATT, has an inbuilt explanation/clarification of "treatment no less favourable" in paragraphs 2 and 3 of Article XVII. Paragraph 2 states:

> A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.

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[199] *EC-Bananas*, Panel Report, para. 7.322.
[200] *Ibid.*
[201] *Japan-Alcoholic Beverages*, AB Report, pp. 20-1.

And Paragraph 3 defines the criteria in paragraph 2 as follows:

> Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services and service suppliers of any other Member.

The provisions in GATS Article XVII paragraphs 2 and 3 incorporate the evolution of GATT jurisprudence of the "treatment no less favourable" standard determined and interpreted over the years by dispute settlement cases. It has been established that this standard refers to the modification of competition: the interpretation of no less favourable treatment standard is one of ensuring no less favourable conditions of competition. Article III:4 of the GATT obliges WTO Members to accord "treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting internal sale, offering for sale, purchase, transportation, distribution or use." The Panel interpreted this provision in *United States – Section 337* as follows:

> The words 'treatment no less favourable' in paragraph 4 [of GATT Article III] call for *effective equality of opportunities* for imported products in respect of the application of laws, regulations and requirements [...][202]

The standard prohibits measures that might adversely affect the conditions of competition facing imported products relative to domestically produced goods. Thus there can be differential treatment, as long as this does not result in the imported product being in a less favourable position to compete in the domestic market. Other GATT cases have held that "treatment no less favourable" means equal conditions of competition between domestic products and imported ones,[203] and that it protects

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202 *United States – Section 337 of the Tariff Act of 1930*, Panel Report, , BISD 36S/345, L/6439, adopted 7 November 1989,para. 5.11. Emphasis added.
203 *Italian Discrimination against Imported Agricultural Machinery*, BISD 7S/60, 64, L/833, adopted 23 October 1958, paras. 11-13.

expectations of the contracting parties rather than specific outcomes.[204] The WTO panels and Appellate Body have endorsed these interpretations of the GATT panels.[205]

The provisions of Article III as a whole together ensure that imported products are not subject to discriminatory internal measures. The national treatment obligation under GATT Article III is "a general prohibition on the use of internal taxes and other internal regulatory measures so as to afford protection to domestic production."[206] Article III protects "expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products".[207]

In *EC-Bananas*, the Panel had to consider GATS Article XVII with respect to the different EC licenses.[208] The Panel found them all to be inconsistent with GATS national treatment. The Panel straightforwardly applied paragraphs 2 and 3 of Article XVII to determine "treatment no less favourable" and confirmed that "formally identical treatment" may be considered to be less favourable treatment if it adversely modifies conditions of competition for foreign services and services suppliers in favour of like domestic ones. Thus the Panel applied the provision to determine whether the EC licensing rules in question have an impact on the conditions of competition for foreign service suppliers.[209] The Panel found that all the licenses in question create less favourable conditions of

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[204] *US-Taxes on Petroleum*, BISD 34S/136, L/6175, adopted 17 June 1987, para. 5.1.9.
[205] See *Japan-Alcoholic Beverages*, Panel and Appellate Body Reports.
[206] *Japan-Alcoholic Beverages*, AB Report, p. 17.
[207] *Japan-Alcoholic Beverages*, AB Report, p. 15.
[208] See Section IV.4 above for facts of the case.
[209] *EC-Bananas*, Panel Report, para. 7.327.

competition for like service suppliers of foreign origin therefore they were inconsistent with GATS Article XVII.[210]

The Appellate Body also examined the consistency of the EC measures with GATS Article XVII and agreed with the Panel's analyses and conclusions and thus upheld all of the Panel's conclusions with regard to GATS Article XVII.[211] In addition, the Appellate Body rejected the EC's argument that the "aims and effects" of a measure should be considered in determining whether a measure modifies the conditions of competition and thus inconsistent with GATS Article XVII.[212]

There are difficulties in the interpretation of the GATS national treatment principle which are not similarly present in regard to goods. The first is raised by the difference between the text of Article XVII and the manner in which commitments on national treatment are scheduled.[213] The question is whether the national treatment obligation extends across all four modes of supply, or do Members retain the freedom to discriminate between identical services supplied in their territory through different modes – for instance in the situation where a Member may have inscribed national treatment commitments for modes 1 and 2 but have not done so under modes 3 and 4.?[214]

Mattoo observes that the structure of the schedules implies that a Member's commitments are mode-specific.[215] The wording for GATS Article XVII does not refer to modes of supply, as does the specific

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210 *EC-Bananas*, Panel Report, paras. 7.341, 7.368, 7.380.
211 See *EC-Bananas*, AB Report, paras. 241, 243-244, 246, 248.
212 *EC-Bananas*, AB Report, para. 241.
213 A. Mattoo, 31(1) *JWT* (1997), at p. 119. Another difficulty with GATS national treatment obligation is that to determine the precise limitations scheduled on national treatment, we must also look to the market access column and determine what limitations on market access has been scheduled in cases of overlap. This is due to the nature of scheduling commitments on services as specified in Article XX:2 of the GATS (see Section IV.2 above). This adds to the confusion and difficulty in interpreting a Member's services schedule.
214 *Ibid.*
215 *Ibid.*

obligation of market access in GATS Article XVI.[216] Members' commitments to provide national treatment have, however, been specified mode by mode. Mattoo points out that this approach to scheduling commitments,

> necessarily implies a fragmentation of the national treatment obligation in a way that is not anticipated in the text of the Agreement – for a Member may retain the right to discriminate between identical services supplied through different modes by not guaranteeing national treatment with respect to each mode.[217]

In the case of *Canada-Automotive*,[218] the Panel decided that a Member cannot maintain discriminatory measures between like services supplied through different modes. The Panel stated:

> We note that the CVA requirements in the MVTO 1998 and SROs do not discriminate between domestic and foreign services and service suppliers operating in Canada under modes 3 and 4. This observation, however, does not suffice to conclude that the requirements of Article XVII are met. In our view, it is reasonable to consider for the purposes of this case that services supplied in Canada through modes 3 and 4 and those supplied from the territory of other Members through modes 1 and 2, are "like" services. In turn, this leads to the conclusion that the CVA requirements provide an incentive for the beneficiaries of the import duty exemption to use services supplied within the Canadian territory over "like" services supplied in or from the territory of other Members through modes 1 and 2, thus modifying the conditions of competition in favour of services supplied within Canada. Although this requirement does not distinguish between services supplied by service suppliers of Canada and those supplied by service suppliers of other Members present in Canada, it is bound to have a discriminatory effect against services supplied through modes 1 and 2, which are services of other Members. [219]

It is important to note here that the Panel has compared services supplied through modes 3 and 4, which include those supplied by both domestic and foreign suppliers, to foreign services that are supplied through the different modes of 1 and 2 and found them to be "like services". In this way the Panel determined that Canada violated its GATS national treatment obligation because the CVA requirements on

[216] See GATS Article XVI:1.
[217] A. Mattoo, 31(1) *JWT* (1997), at p. 121.
[218] See Section IV.4 above for facts of the case.
[219] *Canada-Automotive*, Panel Report, para. 10.307.

manufacturer beneficiaries accord less favourable treatment to services of other Members supplied through modes 1 and 2.[220]

Article XVII:2 of the GATS makes it clear that limitations on national treatment cover both *de jure* and *de facto* discrimination. The Panel, in the finding quoted above, essentially found that there was *de facto* discrimination because although there was no discrimination regarding services supplied through modes 3 and 4 between Canadian and non-Canadian suppliers, there was *potential* for discrimination of like services supplied through modes 1 and 2, which were services of other Members.

The national treatment obligation has often been a source of complaint or dispute in the GATT and the WTO. This is mainly because it refers to *domestic* regulatory measures, and is therefore intimately related to various governmental measures (such as taxation) that may be based on legitimate policy reasons that are not necessarily designed to restrict imports.[221] The fact is that "striking an appropriate balance between, on the one hand, allowing regulators the freedom to make distinctions between services products and, on the other, preserving liberal trading conditions, will be even more difficult in services than it has been in goods."[222]

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220 *Canada-Automotive,* Panel Report, para. 10.308. Canada did not appeal on this point when the case came before the Appellate Body, and therefore the opportunity did not arise for the Appellate Body to decide on the Panel's legal reasoning.
221 John H. Jackson, *The World Trading System* (1997), p. 213.
222 A. Mattoo, 31(1) *JWT* (1997), p. 107.

6. Market Access

Another important GATS specific commitment provision is Article XVI on market access. Like the national treatment provision, Article XVI only applies to measures affecting those services sectors inscribed in a Member's schedule of specific commitments and are negotiated as multilateral packages.[223] Market access is not specifically defined in the GATS, but in the WTO framework market access outlines "the government-imposed conditions under which a product may enter a country under non-discriminatory conditions".[224] In the case of trade in services, market access is expressed through governmental regulations within the borders of the domestic market. Article XVI:1 extends market access with regard to the commitments made in the schedules on an MFN basis, subject to any terms, limitations and conditions specified in the schedule.

Article XVI establishes the provisions to deal with trade-restrictive regulatory measures. The second paragraph of the GATS market access provision contains an exhaustive list of measures that are inconsistent with market access commitments which cannot be maintained or adopted in a service sector where market access commitments are undertaken, unless they are otherwise specified in a schedule.[225] There are six types of restrictions expressly stipulated in Article XVI:2 as being contrary to the market access obligation: (i) limitations on the number of service

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[223] See GATS Articles XVI, XIX and XX.
[224] Walter Goode, *Dictionary of Trade Policy Terms* (2003), p. 222.
[225] In contrast, GATS Article XVII on national treatment does not contain such a list. Thus, under Article XVII, any measure which affects conditions of competition to the detriment of foreign services or suppliers, in committed service sectors, must be scheduled.

suppliers; (ii) limitations on the value of services transactions or assets; (iii) limitations on the number of service operations or quantity of service output; (iv) limitations on the number of natural persons that may be employed; (v) limitations on the forms of legal entity; and (vi) limitations on the participation of foreign capital.[226]

Members can avoid scrutiny of this provision by deciding not to inscribe certain sectors. In the service sectors which they do inscribe, they may list limitations as defined in Article XVI:2. The question arises as to the situation regarding measures that limit market access but do not fall into one of the six categories in paragraph 2: do these measures need to be scheduled? A number of sources suggest that the only limitations on market access allowed to be scheduled are those listed in Article XVI:2.[227] The WTO Guide states that the six elements set out in Article XVI:2, between them, cover all the aspects of limitation of market access that may be specified in national schedules.[228] The Council for Trade in Service's Scheduling Guidelines also states that the list is exhaustive.[229]

In addition, although the Panel in *Mexico-Telecommunications* did not state explicitly on the exhaustiveness of Article XVI:2 list, from its analysis of Mexico's scheduled limitations in respect of Article XVI:2 we can infer that the Panel was of the view that Article XVI:2 list is exhaustive.[230] The Panel stated:

> [Article XVI:2] contains *six categories* of measures that restrict market access ... Mexico's routing restriction has three main elements ... We assess each of these elements in turn, with respect to their relevance to the *six categories* of market access measure set out in Article XVI:2.[231]

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[226] Patrick Low raises the question whether the list in Article XVI:2 is in fact exhaustive. He suggests the provision is unclear on the matter (see comment by Patrick Low in Sauvé and Stern (2000), p. 137). Most analysts take the view that the list is exhaustive.

[227] Low and Mattoo (2000), p. 454; *WTO Guide* (1999), p. 171.

[228] *WTO Guide* (1999), p. 171.

[229] See WTO, *Scheduling Guidelines*, adopted 23 March 2001, S/L/92, 28 March 2001, para. 8. (*Scheduling Guidelines*).

[230] See Panel Report, WT/DS204/R, paras. 7.77-7.78; see Chapter 4.

[231] *Ibid.* Emphasis added.

The Panel in the most recent WTO case on trade in services, *US-Gambling*, also determined that Article XVI:2 list is exhaustive:

> The ordinary meaning of the words, the context of Article XVI, as well as the object and purpose of the GATS confirm that the restrictions on market access that are covered by Article XVI are only those listed in paragraph 2 of this Article.[232]

A number of clarifications on the scheduling of commitments under market access and national treatment are expounded in the WTO Guidelines on Scheduling.[233] First, if a measure – for instance approval procedures or licensing and qualification requirements – is non-discriminatory in nature, it should not be scheduled under Article XVII national treatment. Second, if it does not contain any of the limitations listed in Article XVI:2, it should also not be scheduled under Article XVI on market access. If the measure is discriminatory, but does not contain the limitations listed in Article XVI, it should be scheduled under national treatment. If, however, it is discriminatory and contains any of the limitations listed in XVI, it should be scheduled as market access limitations even if it may also contain limitations on national treatment.[234] If the measure is non-discriminatory and contains any of the limitations listed in XVI:2, then it must be scheduled under the market access column. Thus *all* measures falling under any of the categories listed in Article XVI:2 must be scheduled under market access, whether or not they are discriminatory according to the national treatment standard of Article XVII.[235]

232 WTO, *US – Measures affecting the Cross-Border Supply of Gambling and Betting Services*, Report of the Panel, WT/DS285/R, 10 November 2004 (*US-Gambling*), para. 6.318; see also paras. 6.292-6.317. The Panel Report has not yet been adopted because the US has appealed the decision, see WTO, *US-Gambling*, Notification of an Appeal by the United States, WT/DS285/6, 13 January 2005.
233 *Scheduling Guidelines*, S/L/92.
234 See GATS Article XX:2.
235 See *Scheduling Guidelines*, paras. 8-18.

Furthermore, minimum requirements such as those common to licensing criteria, for example minimum capital requirements for the establishment of a corporate entity, do not fall within the scope of Article XVI. If such a measure is discriminatory within the meaning of Article XVII and, if it cannot be justified as an exception, it should be scheduled as a limitation on national treatment. There are certain government measures not subject to scheduling. Domestic regulations which do not fall under the six categories of limitation in Article XVI:2 and which do not discriminate against foreign suppliers are not subject to scheduling. Most of them are subject to the disciplines of GATS Article VI on domestic regulation, in particular Article VI:5.[236] Such measures, if cannot be justified as exceptions, must be brought into conformity with Article VI:5.[237]

All quantitative limits on services and service providers are dealt with under Article XVI and include both discriminatory and non-discriminatory measures.[238] GATS national treatment, as explained, is defined in the same way as in the GATT: the non-discriminatory application of domestic regulations to foreign services and service providers. It thus follows that quantitative limits placed on foreign services or providers fall under both the market access and national treatment provisions. This creates a situation of overlap between the two provisions on market access and national treatment.

To avoid the duplication of scheduling the same limitations in both the market access and national treatment columns, Article XX:2 states

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236 There are, however, some regulations, such as competition law, which do not fall under either Articles XVI, XVII nor VI of the GATS. WTO, *Market Access: Unfinished Business, Special Studies 6*, p. 103.

237 *Scheduling Guidelines*, para. 11.

238 See *Scheduling Guidelines*, paras. 8-18.

that measures inconsistent with both Articles XVI and XVII are to be inscribed in the column relating to market access, and the inscription in this case will be considered to provide a condition or qualification to Article XVII as well.[239] Although Article XX:2 was intended to clarify the situation, Feketekuty points out that the provision "introduces a discrepancy between the text of the provisions in Article XVI and XVII on the one hand, and the content of the market access and national treatment columns in the national schedules on the other."[240] This has led some countries to believe wrongly that national treatment commitments become operative only after they have made a commitment in market access.[241]

Does this overlap create a hierarchy between Articles XVI and XVII commitments in relation to Article XX:2?[242] In other words, is a national treatment commitment subsidiary to a market access commitment or whether once granted, does national treatment apply to all future market access commitments?[243] Substantive discussions on the issue first took place in the Council for Trade in Services in June 2002, lasting for one year, after which it was handed over to the Committee on Specific Commitments (CSC).[244] The CSC discussed this issue for the first time at

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[239] GATS Article XX:2.
[240] Feketekuty (2000a), p. 96.
[241] *Ibid.*
[242] See reports of the meetings of the Committee on Specific Commitments from September 2003 to March 2004: WTO, CSC, *Report of the Meeting Held on 29 September 2003*, S/CSC/M/30, 1 December 2003, paras. 28-44 (CSC 1st meeting); WTO, CSC, *Report of the Meeting Held on 4 December 2003*, S/CSC/M/31, 14 January 2004, paras. 31-74 (CSC 2nd meeting). See also Low and Mattoo (2000), pp. 450-1.
[243] See CSC 2nd meeting, S/CSC/M/31, paras. 33-72.
[244] The CSC discussed the issue over one informal and three formal meetings between September 2003 and March 2004. The CSC reported back to the Council for Trade in Services in March 2004. See WTO, CSC, *Report of the Meeting Held on 22 March 2004*, S/CSC/M/32, 25 May 2004, para. 60 (CSC 3rd meeting); WTO, CTS, *Consideration of Issues Relating to Article XX:2 of the GATS: Report by the Chairman of the Committee on Specific Commitments*, S/C/W/237, 24 March 2004 (Chairman's Report); WTO, CTS, *Report of the Meeting Held on 25 March 2004*, Note by the Secretariat, S/C/M/72, 29 April 2004, paras. 25-35.

its meeting on 29 September 2003. The meetings showed continuing differences among the delegations as to the interpretation of the two overlapping GATS Articles. Some believed that a clear and consistent interpretation of the overlap could be found while others remained doubtful.[245]

To summarize, the commitments on market access and national treatment listed in a Member's schedule contain the negotiated and guaranteed conditions for conducting international trade in services. The market access and national treatment commitments act in tandem – the former relating to assisting entry into the market and the latter to subsequent treatment once new entrants are operating in the market. Market access and national treatment are often cited together when referring to a Member's specific commitments in the GATS.

As a general rule market access and national treatment commitments offered by the majority of WTO Members are subject to limitations. Thus, to determine how open a country's market is, we have to look to its detailed services schedule and determine what market access and national treatment commitments it has made in the specific sectors as well as how many service sectors has it listed in its schedule. To recall, not listing a service sector, for example audio visual services, in its schedule means that that country has not made any commitments to open its market to foreign competition in that particular sector. Thus, the more service sectors listed in a Member's schedule, the more efforts have been made towards liberalization of trade in services. And the most open regime for foreign service providers is obtained when no limitations to either market access or national treatment for any of the technically

[245] Chairman's Report, S/C/W/237, para. 4.

feasible modes of supply are entered in the schedule. In this case, the government undertakes to remove all measures limiting cross-border supply, consumption abroad, commercial presence or the temporary entry of natural persons.

What is market access in the context of telecommunications liberalization? The more sub-sectors on telecommunications services listed in a Member's schedule, the greater the effort is towards telecommunications liberalization. And listing the limitations in both market access and national treatment columns as "none" for all four modes of supply entails full commitments towards liberalization of trade in telecommunications services. The current services negotiations are seeking to achieve as many commitments as possible. Most developed countries have committed extensively to telecommunications services in three of the four modes of supply. Regrettably, most Members, developed and developing countries alike, have made no commitments towards the liberalization of telecommunications services through the movement of natural persons (except as indicated in their horizontal commitments).

Liberalization is not equated with deregulation. The GATS specifically recognizes the right of Members to regulate their service industries. So a scheduled commitment does not necessarily imply liberalization. The majority of commitments negotiated and scheduled in the Uruguay Round were "standstill bindings", committing the country concerned only to maintain the current level of access. More liberalization, however, took place in the post-Uruguay negotiations on basic telecoms and financial services. Nonetheless, stand-still bindings have value. They provide traders and investors with the assurance that the conditions on which their economic and business decisions are based will not be overturned by later policy changes.

7. Domestic Regulation

The GATS recognizes each Member State's right to regulate according to its needs, for instance the need to regulate in the public interest.[246] However, domestic regulation could be restrictive to trade. The GATS, particularly Article VI, thus require that regulatory measures are transparent, non-discriminatory and not unnecessarily restrictive to trade.

GATS Article VI on domestic regulation is, as Feketekuty puts it,

> the essential third leg of a three-legged stool, along with Article XVI on market access and Article XVII on national treatment. While Article XVI disciplines the use of quantitative restrictions, and Article XVII disciplines discriminatory treatment of foreign services and service providers, Article VI disciplines more hidden forms of protection buried in domestic regulations and their administration.[247]

Article VI has six paragraphs, four of which only come into play in sectors where specific commitments have been undertaken.[248] The two most important provisions of Article VI are paragraphs 4 and 5.[249] GATS Article VI:4 stipulates that disciplines on measures relating to qualification requirements and procedures, technical standards and licensing requirements, not falling within the scope of Articles XVI and XVII, shall be

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[246] See Preamble to the GATS. In *Mexico-Telecommunications*, the Panel stated precisely, before going into their decision, that their findings "do not adversely affect the degree of regulatory autonomy which WTO Members, individually and collectively, retain under the GATS, including the right to modify specific GATS commitments pursuant to the procedures and conditions set out in Article XXI of the GATS." Panel Report, WT/DS204/R, para. 7.3.

[247] Feketekuty (2000a), p. 101.

[248] Namely, GATS Article VI, paragraphs 1, 3, 5 and 6.

[249] For more in depth analyses on Articles VI:4 and VI:5, see Nicolaïdis and Trachtman in Sauvé and Stern (2000), pp. 257-264. They discuss Article VI:5 and the two criteria needed to be satisfied before the disciplines in Article VI:5 can be applied. The criteria include nullification and impairment (imported from the GATT concept) and the necessity test (the "measure should not be more burdensome than necessary").

established by the Council for Trade in Services. The idea of Article VI is that disciplines adopted under paragraph 4 should ensure that domestic regulations relating to qualification requirements and procedures, technical standards and licensing requirements are not unnecessary and do not pose barriers to trade in services.

Meanwhile, Article VI:5 applies the objectives listed in Article VI:4(a)-(c) to any new measures that might impair or nullify commitments made in the schedules, pending the negotiations of the disciplines called for in Article VI:4. To date, the only regulatory disciplines to have been developed under GATS Article VI:4 are the Accountancy Disciplines, in which sector the WTO's work on domestic regulation discipline have been focused.[250]

From the work done on this sector, it is clear that Article VI is concerned only with non-discriminatory measures of regulation.[251] The effect of this in practice is that if a Member has not scheduled a national treatment commitment in a sector, there is little that Article VI can do by way of imposing disciplines in that sector.[252] Thus, under the current GATS structure, improvements in market access and national treatment need to go hand in hand with efforts to strengthen the rules on domestic regulation.[253]

A Ministerial Decision on Professional Services established the Working Party on Professional Services (WPPS) on 4 April 1995 to deal with GATS Article VI. The WPPS's role was to implement Article VI:4, for which it gave priority to the accountancy sector and the Accountancy

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250 WTO, *Disciplines on Domestic Regulation in the Accountancy Sector,* adopted 14 December 1998, S/L/64, 17 December 1998.
251 See also *Scheduling Guidelines*, S/L/92, paras. 11 and 14.
252 Low (2000), p. 138.
253 *Ibid.*

Disciplines adopted in December 1998. In April 1999, the Working Party on Domestic Regulation (WPDR) was formed and replaced the WPPS. The WPDR's emphasis is on the development of generally applicable disciplines for all service sectors.[254] The issues under consideration in the WPDR are the necessity test (obligation not to create 'unnecessary barriers to trade'), transparency (requirements in addition to general transparency provisions), equivalence (consideration of professional, education experience, etc. obtained abroad) and international standards (as benchmarks).[255] In the current Doha Round of negotiations, the negotiating guidelines for trade in services adopted on 28 March 2001 states: "Members shall aim to complete negotiations under Article VI:4 ... prior to the conclusion of negotiations on specific commitments."[256]

The provisional nature of Article VI requires that attention should be turned towards clarifying and strengthening this GATS provision.[257] In the Doha Round, the WPDR is currently working on the development of disciplines under Article VI:4 and the representatives have been discussing Japan's proposed paper on an Annex on Domestic Regulation[258] and the EC's proposal for disciplines in licensing procedures,[259] as well as the Secretariat's paper on the necessity test.[260] The work of the WPDR also consists of the issue relating to regulatory disciplines for professional services.

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254 In other words, a horizontal approach. Regulatory policies in individual service sectors are constantly evolving, thus the focus is on work on horizontal elements of Article VI:4.
255 Hamid Mamdouh, Director of Trade in Services Division in the WTO, "The GATS and Domestic Regulation: Introduction", power point presentation at the WTO Workshop on Domestic Regulation from 29-30 March 2004. Available at http://www.wto.org.
256 WTO, *Guidelines and Procedures for the Negotiations on Trade in Services*, S/L/93, 29 March 2001, para. 7.
257 Low (2000), p. 137.
258 JOB(03)/45 and JOB(03)/45/Rev.1.
259 WTO, WPDR, *Communication from the EC – Proposal on Disciplines on Licensing Procedures*, S/WPDR/W/25, 10 July 2003.
260 WTO, WPDR, *"Necessity Tests" in the WTO*, Note by the Secretariat, S/WPDR/W/27, 2 December 2003.

It is important that government regulations are not more burdensome than necessary. This is particularly relevant to infrastructural services such as telecommunications. As seen in Chapter 2, the telecommunications industry, like most other infrastructural industries, was heavily regulated for decades. In recent years, following the initiative begun in the US, countries have deregulated and privatized their telecommunications industries or have introduced competition in the supply market while maintaining regulation with regard to access to and use of telecommunications networks in order to ensure competition. Regulatory disciplines on trade in telecommunications services have been developed in the WTO in the form of the "Reference Paper".[261]

Feketekuty observes that in sectors where regulation tends to be heavy, for instance telecommunications, some degree of international rule-making on a sectoral basis would be inevitable, particularly if regulation limits competition or competitive entry.[262] However, he cautions that the WTO should not establish highly detailed regulations, but instead should focus on "establishing legally binding obligations centered on some key principles and procedures, while leaving much of the substantive detail to other international organizations, national governments, and voluntary private bodies."[263] To this end, the telecommunications Reference Paper could provide a good model from which to begin establishing WTO frameworks on regulatory disciplines for other service sectors, as the elements of flexibility are there in the Reference Paper for which Member governments have room to commit themselves to regulatory principles on telecommunications established by the Reference Paper and at the same

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[261] See Chapter 4.
[262] Geza Feketekuty, "Regulatory Reform and Trade Liberalization in Services", in Sauvé and Stern (2000b), pp. 238-9.
[263] *Ibid.*, p. 239.

time retain the freedom to dictate the precise domestic laws to apply within their borders.

However, it has been observed that both the accountancy and telecommunications experience in domestic regulatory principles still leaves unresolved the question of the desirability and feasibility of horizontal versus sectoral approaches to the domestic regulation/market access interface.[264] Mattoo and Sauve points out that,

> Key questions consulting services negotiators today, therefore, are to what extent can focusing on the various rationales for regulatory intervention provide the basis for developing meaningful horizontal disciplines on domestic regulation under the GATS, and where may it be necessary to take a sector-specific approach.[265]

A number of principles could help governments formulate sound laws and regulations. Most of these are principles of good governance and of a sound legal structure.[266] Each country must decide how best to incorporate these principles into their own domestic laws and regulations. These principles include the following: transparency of laws and regulations; due process in the administration of laws and regulations; predictability; non-discrimination; transparency of regulatory objectives; use of market mechanisms; and minimizing the scope of regulations.[267] The last principle holds that,

> governments should only regulate activities directly related to the achievement of the regulatory objective. Reducing the scope of regulations to the minimum necessary to achieve the desired social objective helps to minimize the economic cost of such regulations.[268]

This principle is particularly relevant to infrastructural services such as telecommunications.

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[264] A. Mattoo and P. Sauvé, *Domestic Regulation and Services Trade Liberalization*, World Bank Trade and Development Series (1 October 2003), p. 4.
[265] *Ibid.*
[266] Feketekuty (2000b), p. 228.
[267] For a detailed analysis of these principles, see Feketekuty (2000b), pp. 228-234.
[268] Feketekuty (2000b), p. 233.

Feketekuty suggests that negotiators dealing with regulatory issues during the current services negotiations in the Doha Round should follow a three-prong approach: 1) they should endeavour to strengthen Article VI of GATS, 2) negotiate sectoral agreements in heavily regulated sectors along the lines of the telecom agreement, and 3) improve commitments incorporated in national schedules.[269] According to Feketekuty, this approach would serve a number of purposes:

> It would keep the degree of intrusion by international rule-making in each sector to the minimum necessary to provide a viable framework for market entry and would open cross-border competition; it would provide a pragmatic basis for developing the most effective route to liberalizing trade in regulated sectors while preserving national preferences to the extent possible; and it would provide alternative means for making progress. Negotiating strengthened disciplines in Article VI is likely to prove an adequate basis for minimizing regulatory barriers to trade in many services sectors, particularly the newer professional services and services related to the information economy.[270]

Article VI is an important provision in the liberalization of telecommunications services. Measures on telecommunications services not subject to scheduling under either market access or national treatment will come under the regulation of Article VI on domestic regulation. Thus, for example, a non-discriminatory measure regarding licensing not falling under one of the six categories in Article XVI:2 must be "administered in a reasonable, objective and impartial manner" (Article VI:1),[271] the application for which must be dealt with within a reasonable period of time (Article VI:3),[272] and must not nullify or impair the specific commitments undertaken (Article VI:5).

As we have seen in this section and the sections on national treatment and market access, the relationship between scheduled

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[269] Feketekuty (2000b), p. 234.
[270] *Ibid.*
[271] The Panel in *US-Gambling* held that Article VI:1 applies to the *administration* of measures of general application, but does not apply to these measures themselves. Panel Report, para. 6.432.
[272] Paragraphs 1 and 3 of Article VI thus contain disciplines of a procedural nature. *Ibid.*

commitments and domestic regulation is a three-way network between Articles XVI and XVII and Article VI. These three-way inter-locking paths, however, require that there is a distinction between measures falling under Articles XVI and XVII which need to be scheduled, and those falling under Article VI, which cannot be scheduled. As we have seen above, if a measure restricts market access and falls under one of the categories listed in paragraph 2 of Article XVI, it must be listed in the market access column. If, however, a measure is discriminatory in nature, and does not fall under the Article XVI:2 list, it must be inscribed in the national treatment column. All other non-discriminatory measures on domestic regulation are subject to the disciplines of Article VI.

However, although Article VI is a general obligation under the GATS, certain provisions of Article VI do not apply unless specific commitments have been undertaken.[273] Thus, there is a limitation to the scope of GATS Article VI as an effective tool in regulating domestic measures to ensure that they are not more restrictive to trade than necessary. Low and Mattoo identify the following significant point:

> While it might be argued that the application of regulatory disciplines independently of the existence of specific commitments would be desirable because it would enhance the conditions of competition in the market, as a practical matter the value of regulatory disciplines in the absence of trade liberalization commitments would be very limited. The legal device of maintaining Articles XVI and XVII entirely separate from Article VI facilitates interpretation but does not alter the fact that in the absence of specific commitments, limitations on market access and national treatment can render Article VI disciplines ineffective. This conclusion suggests the need for a parallel approach to regulation and liberalization.[274]

[273] See GATS Article VI, paragraphs 1, 3, 5 and 6.
[274] Low and Mattoo (2000), pp. 455-6.

8. Transparency Obligations

The other general obligation important to the telecommunications sector, and one of the cornerstones of the multilateral trading system, is transparency. Article III of the GATS requires that Members publish all relevant laws and regulations affecting trade in services, including international agreements to which they are signatories.[275] Each Member must also respond promptly to any other Member's request for specific information on any of its measures, and enquiry points must be established by each Member to provide specific information on matters of a Member's laws and regulations.[276] These provisions are intended to provide the WTO and all its Members adequate information about Members' practices.

This obligation is specifically extended to telecommunications in the GATS Annex on Telecommunications. The Annex transparency obligation requires that relevant information on conditions affecting access to and use of public telecommunications transport networks and services is publicly available.[277] This requirement means that information on the telecommunications sector of a Member country such as tariffs, specifications of technical interfaces, and regulatory bodies that have previously been made available in only a few countries, must now be published and readily obtainable. With transparency obligations, a foreign investor hoping to start up a business in telecommunications in a WTO

[275] GATS Article III:1.
[276] GATS Article III:4. The GATS, however, makes clear that a Member is not required to disclose confidential information which would impede law enforcement, is contrary to the public interest, or which would prejudice legitimate commercial interests of particular enterprises. Article III *bis*.
[277] Section 4 Annex on Telecommunications.

Member country could be assured, at least in theory, of being able to acquire the necessary information on the market it seeks to enter.

The transparency principle is one of the key elements for promoting a rules-based approach to trade policy and domestic measures, and to facilitate the monitoring of compliance with WTO obligations with a view to avoiding disputes and thereby contribute to the stability and predictability of the international trading system.[278] Through stability and predictability of the markets, the liberalization of telecommunications services can also be advanced.

[278] See WTO, WGTCP, WT/WGTCP/W/114, 14 April 1999, para. 57.

Chapter 4

The Liberalization of Telecommunications Services in the WTO

The liberalization of trade in telecommunications services took on a new global dimension when a multilateral framework governing trade in telecommunications services was adopted in the WTO. The Agreement on Basic Telecommunications (ABT), which entered into force on 5 February 1998, is the result of the successful conclusion of the extended WTO negotiations on basic telecommunications services held after the Uruguay Round.

The Agreement on Basic Telecommunications, as it is commonly known, is the Fourth Protocol to the GATS. Annexed to this Protocol are Schedules of Specific Commitments and Lists of GATS Article II Exemptions. It is not a single agreement of trade rules on telecommunications services as such. In addition to the ABT, the negotiations on basic telecommunications also generated a paper containing guidelines on regulatory principles known as the Reference Paper. The Reference Paper is the key to the liberalization of telecommunications services and the process of promoting and maintaining competition in the telecommunications sector.

Although an international organization on telecommunications has existed since 1865, there has been no international framework of rules that governed trade in telecommunications services on the global scale that the WTO does.[1] Not only has the WTO adopted an agreement regulating trade in telecommunications services, global trade in telecommunications services is now subject to the dispute settlement procedures of the WTO. The consequence of this is a more open, transparent, enforceable and predictable environment in telecommunications trade.

The first section of the chapter sets out the history of the multilateral negotiations on telecommunications services from the Uruguay Round until the adoption of the Fourth Protocol. This section also examines the characteristics of the telecommunications sector and the tradeability of telecommunications services, focusing in particular on the distinction between the two types of telecommunications services, basic and value-added. The second section provides an analytical examination of the liberalization of telecommunications services in the WTO by examining the ABT, together with the Reference Paper on regulatory principles, and the GATS Annex on Telecommunications. In the final section, we analyze the Panel's decision on the WTO's first dispute case on telecommunications services and evaluate the Panel's interpretation of the WTO rules on telecommunications services.

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[1] On 17 May 1865, twenty European countries established the International Telegraph Union – one of the oldest world-wide international organizations – to oversee cross-border telegraphy. The successor to the International Telegraph Union is the International Telecommunications Union (ITU) which was founded in 1932 and became a specialized agency of the United Nations in 1947. The role of the ITU in the governing of international telecommunications has in recent years been over-shadowed by other regional bodies and, more importantly, the WTO.

I. The GATT/WTO Negotiations on Telecommunications Services (1986-1997)

Negotiations on telecommunications services in the Uruguay Round of multilateral trade negotiations began in 1989, three years after the Round commenced. It was decided during the mid-term review meeting of the Trade Negotiations Committee (TNC) in Montreal in December 1988 that the Group on Negotiations on Services (GNS) should proceed with its plans to undertake sectoral discussions on the applicability of GATT principles and rules to trade in services, alongside the main negotiations on trade in services.[2] A working group on telecommunications services (WGTS) was instructed by the GNS to hold discussions, over four meetings, on the specific service sector of telecommunications.[3] It was mandated to assess whether a specific annex, in addition to a general agreement on services, was or was not necessary for the telecommunications sector, and to identify the issues/provisions that might need to be annotated and the nature and content of a possible annotation.[4] However, in the absence of an agreed overall framework on trade in services, it was not easy for the WGTS to carry out these tasks.

During these sector-specific negotiations on telecommunications, a number of important concerns were identified. First, there was the issue of whether telecommunications services are merely a mode of delivery or

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[2] J.V. Reyna, "Services", in *The GATT Uruguay Round: A Negotiating History* (Volume 2) (T.P. Stewart, ed.) (1993), p. 2369; GATT, *Mid-term Review*, GATT Doc. No. MTN.TNC/11, 21 April 1989.

[3] There were also working groups for each of the following service sectors: financial services (also had 4 meetings); construction and engineering services; tourism services; transport services; professional services (which gave priority to accounting services); audiovisual services; and labour mobility.

[4] GATT, GNS, *Note on the Meeting of 22 October 1990*, MTN.GNS/39, 5 December 1990, para. 2.

whether it is a service sector in its own right. This issue pertains to the dual-role of telecommunications services. Second, there was the issue concerning the distinction between "basic" and "non-basic" telecommunications services.[5] These issues warrant further analysis due to the influence they had on the telecommunications negotiations during and after the Uruguay Round.

1. *Telecommunications: A Dual Role*

It is no longer disputed that telecommunications has a "dual role as a distinct sector of economic activity and as the underlying transport means for other economic activities."[6] In the early stages of the Uruguay Round negotiations, it was not yet accepted that telecommunications was a service sector in its own right meriting an annex with rules specific to the sector, let alone a multilateral agreement such as the ABT.[7]

Three main inter-linking factors help to explain this dual role. Firstly, developments in technology and changing regulatory frameworks have caused the telecommunications industry to move from traditionally

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[5] The latter is now referred to as either "value-added" or "enhanced" telecommunications services. "Enhanced" telecommunications services is the US terminology. Other terms used for basic/non-basic telecommunications services included reserved/competitive, infra-structural/super-structural, excluded/covered, to name but some. GATT, WGTS, *Note on the Meeting of 9-11 July 1990*, MTN.GNS/TEL/2, 6 August 1990, para. 104. The WGTS did not produce precise definitions for the two different telecommunications services. Although different terminology was used by delegations during the discussions in the working group, there was a general agreement on the distinction between these two types of telecommunications services. Even during the extended negotiations on basic telecommunications (1994-1997), negotiators chose not to develop a definitive listing of what constitutes basic telecommunications, but agreed that the negotiations will cover any and all telecommunications services that involve simple transmission (i.e. without adding value).

[6] GATS Annex on Telecommunications, Section 1.

[7] See the report of the first meeting of the WGTS: GATT, WGTS, *Note on the Meeting of 5-6 June 1990*, MTN.GNS/TEL/1, 27 June 1990. Some Contracting Parties, Hungary and Chile for instance, argued that the general rules and principles in the negotiating GATS cover all services and thus were also sufficient for telecommunications services; See *ibid.*, para. 65 and GATT, WGTS, MTN.GNS/TEL/2, para. 110.

regulated or state-owned monopolies providing limited and largely undifferentiated services to an advanced, fast-moving industry supplying an increasing diversity of services and products.[8] This has been the trend since the early 1980s in most developed countries, particularly the US and Europe.[9] Rapid technological advancement in telecommunications coupled with pro-competitive policies further resulted in the blurring of definitions and neat categorization of telecommunications services and products. This is described as convergence, the second factor contributing to telecoms' dual role.

Convergence in the telecommunications industry means that a clear demarcation line between for example broadcasting, traditional voice telephony and computer services can no longer be maintained. Convergence allows the telecommunications industry to supply more differentiated, fast and efficient services. This enables telecommunications to provide an underlying means of transport for other economic activities, in particular services. Bank transactions, for example, can now be done over the phone, the Internet or the television. The development and changes in the telecommunications industry over the past decades, creating more and better services and fusing them, have allowed for the increased tradeability of telecommunications services.

The increased tradeability of telecommunications services is a third contribution to the duality of telecommunications as an underlying transport mode for other services and as an economic sector in its own right. The globally interconnected telecommunications networks contribute to this tradeability and in turn provide for a multitude of other

[8] GATT, Note by the Secretariat, *Trade in Telecommunications Services*, MTN.GNS/W/52, 19 May 1989.
[9] See Chapter 2 on the evolution of the US telecommunications industry.

service sectors such as financial services, professional services and insurance services.[10]

2. Basic and Value-Added Telecommunications

The distinction between the two types of telecommunications services, basic and non-basic (or value-added), was raised as an important issue during the negotiations because the US, the largest telecommunications market in the world at the time,[11] applied this distinction in its telecommunications industries and insisted upon applying the distinction in the GATT negotiations. As a consequence, this issue structured the debate on telecommunications during the Uruguay Round that resulted in the diversity of commitments made in telecommunications and the extended negotiations on basic telecommunications after the Round. An examination of the origin of this distinction can provide us with a historical grounding and understanding of the GATT/WTO negotiations on telecommunications and their outcome with respect to the commitments made.

The two distinct areas of basic and value-added telecommunications services arose from the advancement in telecommunications technology and was applied for regulatory purposes.[12] Technological developments have allowed for innovative ways to provide traditional telecommunications services and to develop entirely new telecommunications services. As telecommunications services became increasingly diverse and

[10] GATT, *Trade in Telecommunications Services*, MTN.GNS/W/52 (1989), para. 3.
[11] Since July 2004, China is now the world's largest telecommunications market, with 305 million cellular subscribers and 295 million fixed-line users. *The Economist*, "Telecoms in China: Disconnected", 28 August-3 September 2004, p. 59.
[12] GATT, MTN.GNS/W/52 (1989), paras. 6-11.

sophisticated, governments and inter-governmental organizations responded by developing different classifications of telecommunications services. The International Telecommunications Union (ITU), for instance, considered the telecommunications sector as comprising traditional services and value-added telecommunications services. Traditional telecommunications services, according to the ITU, included voice telephony, message telegraphy, telex, facsimile, data transmission and those telecommunications services limited essentially to transmission and switching[13] functions. These are essentially basic telecommunications services. Value-added services, on the other hand, had additional functions beyond transmission and switching, for example data storage, incorporated into the services and these were distinguished from traditional services.

In the US, the distinction between basic and enhanced telecommunications services could be traced back to the 1956 Consent Decree which created an operating barrier for AT&T.[14] As explained in Chapter 2, the barrier which prevented AT&T from entering the computers market relied upon a technological distinction between telecommunications and data processing, and the corresponding boundary between common carrier and non-common carrier activities. The 1956 Decree, a result of the US Department of Justice's anti-trust actions against AT&T, was intended as a check on the monopolistic powers of the telecom operator.

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[13] "switched" – "relates to a telecoms network comprising at least one exchange and capable of routing signals and messages from one line to all other lines comprised in the network". Oftel Glossary at http://www.ofcom.org/static/archive/oftel/publications/glossary/index.htm. See also Chapter 2.

[14] See Chapter 2, Section III.1.

The FCC later confirmed the significant distinction between the two categories of telecoms services in the *Second Computer Inquiry* case,[15] where the distinction was made by the FCC in order to determine its jurisdiction in regulating the telecoms services in question.[16] It was an attempt by the FCC to separate those telecommunications services which could be considered as common carriage, and therefore subject to restrictions, from those which could be offered competitively.[17] When telecommunications were provided by national monopolies, telecommunications services have typically included local and long-distance voice telephony over the public-switched network,[18] and the bulk of international telecommunications activity was mainly voice telecommunications, which is classified as basic telecommunications.[19] There were few if any value-added services and no resale or sharing of telecommunications capacity. As seen in Chapter 2, the changes in the US telecommunications industry were brought about by advances in technology, the inventions of microwave and computers for instance, which allowed the emergence of competition in an industry once dominated by a single firm.

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[15] FCC, *In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, Notice of Inquiry and Proposed Rulemaking, 61 FCC 2d 103 (1976); Final Decision, 77 FCC 2d 584 (1980).

[16] The Second Computer Inquiry revisited the issue of value-added services, which first arose before the FCC in First Computer Inquiry, due to confusion arising from that decision. FCC, *In the matter of Regulatory and Policy Problems Presented by the Interdependence of Computer and Communications Services and Facilities (First Computer Inquiry)*, Final Decision and Order, 28 FCC 2d 267 (1971). See also FCC, *Second Computer InquiryI* (1986).

[17] As explained by Bronckers and Larouche, the distinction between basic and value-added services stems from "the idiosyncrasies of U.S. telecommunications regulation" and does not reflect any inherent differences between the two groups of telecommunications services. Marco Bronckers and Pierre Larouche, "Telecommunications Services and the World Trade Organization", 31(3) *JWT* (June 1997), p.5 at 17-18.

[18] "public switched telephone network" – "a telecoms network used, in whole or in part, for the provision of publicly available telecoms services." - Oftel Glossary at http://www.ofcom.org/static/archive/oftel/publications/glossary/index.htm.

[19] GATT, MTN.GNS/W/52 (1989), paras. 6-11.

The distinction between basic and value-added telecommunications services became one of the highlighted issues during the meetings of the WGTS. It was discovered that although the distinction between basic and value-added telecommunications services was made for the purposes of regulation, there were differences as to how basic telecommunications services were defined in the national markets of the Contracting Parties. The US telecommunications regulatory system, although distinguishing between these two types of telecommunications services, does not contain an express definition of basic telecommunications services. Instead, the FCC has equated them with traditional common carrier services, and that they are limited to the simple transmission of customer information.[20] In Japan, on the other hand, the concept of "basic" telecommunications services is not provided for as such in the regulatory framework.[21] Japan does not regulate its telecommunications industry on the basis of a distinction between basic and value-added services but on the distinction between operators.[22] Operators in Japan are divided into Type I and Type II carriers. Type I carriers are operators who provide services through their own transmission facilities while Type II carriers provide services through leased transmission facilities.[23]

Even in the WTO agreements, the terms basic telecoms services and value-added services are not formally defined in the GATS or in any of the

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[20] *Second Computer Inquiry*, Final Decision (1980) at para. 93; WTO, NGBT, Communication from the United States, Response to Questionnaire on Basic Telecommunications, S/NGBT/W/3/Add.13, 21 October 1994, para. 1.
[21] WTO, NGBT, *Communication from Japan, Response to Questionnaire on Basic Telecommunications*, S/NGBT/W/3/Add.17, 25 October 1994.
[22] GATT, WGTS, MTN.GNS/TEL/1, para. 17.
[23] The former is known as "facilities-based" operators and the latter, "non-facilities based" operators.

agreements on telecommunications.[24] There are a few places in the WTO framework where a "description" of basic telecommunications can be found. The Decision on Negotiations on Basic Telecommunications referred to basic telecommunications as "telecommunications transport network and services".[25] In the Annex on Telecommunications, "public telecommunications transport services", which are equivalent to what the US call "common carrier basic services",[26] is defined as,

> Any telecommunications transport service required ... by a Member to be offered to the public generally. Such services may include, *inter alia*, telegraph, telephone, telex, and data transmission typically involving the real-time transmission of customer-supplied information between two or more points without any end-to-end change in the form or content of the customer's information.[27]

Examples of basic telecommunications services are listed in Sections 2.C(a)-(g) of the Services Sectoral Classification List[28] and these include voice telephone services, packet-switched data transmission services, circuit-switched data transmission services, telex services, telegraph services, facsimile services, private leased circuit services. Due to rapid advancements in technology, however, new telecommunications services are developed all the time and commitments for these services could be made under the category of "other" in the Sectoral Classification List.

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[24] On the WTO website, basic telecommunications services are described as including "all telecommunication services, both public and private that involve end-to-end transmission of customer supplier information." Meanwhile, value-added services are "telecommunications for which suppliers 'add value' to the customer's information by enhancing its form or content or by providing for its storage and retrieval." See, http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_coverage_e.htm#basic. Even the ITU had no provisions distinguishing between categories of services or facilities sometimes categorized as basic or enhanced. GATT, WGTS, MTN.GNS/TEL/2, para. 109.

[25] Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Decision on Negotiations on Basic Telecommunications, 15 April 1994, para. 1.

[26] GATT, WGTS, MTN.GNS/TEL/1, para. 23.

[27] GATS Annex on Telecommunications, Section 3(b).

[28] WTO, Note by the Secretariat, *Services Sectoral Classification List*, MTN.GNS/W/120, 10 July 1991.

Examples of telecommunications services listed under this category are mobile data services, paging, and teleconferencing.

As for "enhanced" or "value-added" services, these are defined in the US regulatory system by the FCC as,

> services, offered over common carrier transmission facilities used in inter-State communications, which employ computer processing applications that act on the format, content, code protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information.[29]

Examples of value-added services are listed in sections 2.C(h)-(n) of the Services Sectoral Classification List and they include electronic mail, voice mail, on-line information and data base retrieval, electronic data interchange, enhanced facsimile services, code and protocol conversion, and on-line data information and/or data processing.

The incorporation of the US distinction between basic and value-added services into the negotiations on telecommunications had a central and complicating influence on the negotiations from 1986 until the adoption of the Fourth Protocol in 1997. Initial difficulties arose in the WGTS meetings when the US objected to the application of the MFN principle to basic telecommunications for fear of "free-riders" abusing the US's open telecommunications market.[30] Allowing the MFN principle to apply to basic telecommunications would mean that operators from other countries, including non-liberalized ones, who have signed up to the GATS could take advantage of the open and liberalized telecommunications market of the US. These "free-riders" would be able to gain immediate access to the US basic telecommunications market while denying US

[29] 47 CFR Sec. 64.702(a). (Section 64.702(a) of the FCC's Rules and Regulation, Code of Federal Regulations).
[30] See the WGTS's note on the fourth and last meeting: GATT, WGTS, *Note on the Meeting of 15-17 October 1990*, MTN.GNS/TEL/4, 30 November 1990.

operators entry into their basic telecommunications markets which for the most part are provided through monopolies.[31]

The US pointed out that it had opened its market to all suppliers, including foreign ones, but that this was not reciprocated in the rest of the world. The US argued that,

> Given this highly asymmetrical situation between the US basic telecommunications market and that in most of the rest of the world, an MFN obligation on basic telecommunications services would have a negative impact on the US.[32]

This recurring "free-rider" problem could be solved, according to the US, if other governments liberalized basic telecommunications in their respective states. The US thus submitted a proposal on liberalizing basic long-distance services in December 1991 whereby all GATT members would have had to remove all existing market entry barriers on basic telecommunications services for foreign suppliers.[33] Most countries, including the industrialized countries of the EC, Japan and Canada, were not prepared to adopt such a far-reaching move at the time and the US withdrew its proposal.[34]

The Uruguay Round therefore concluded without an agreement on basic telecommunications. What was successfully accomplished in

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[31] *Ibid.*

[32] *Ibid.*, para. 16.

[33] M. Fredebeul-Krein and A. Freytag, "Telecommunications and WTO Discipline: An assessment of the WTO agreement on telecommunication services", 21(6) *Telecommunications Policy* (1997), at p. 483.

[34] *Ibid.*, p. 483; Reyna (1993), p. 2422. During the Uruguay Round negotiations, it seemed that the US was the only major industrialized country that favoured liberalization in basic telecommunications. This could be explained by the fact that the US was the most advanced country in terms of telecommunications liberalization at the time and whose telecommunications companies were therefore looking to expand the market beyond the borders of the US. The US had begun to 'liberalize' its telecoms industry since the divestiture of AT&T in 1984 (see Chapter 2). Europe, on the other hand, had only begun to consider liberalization of telecoms in the late 1980s, with the release of the Commission's 1987 Green Paper. Although the UK was the first to embark on a 'liberalization' process of telecoms with the privatization of BT in 1981, no other country in Europe did the same until the 1990s on the initiative of the Commission. As argued above by the US, its liberalized market is a target for free-riders unless other countries liberalize their respective basic telecommunications markets.

telecommunications at the end of the Round was the Annex on Telecommunications, attached to the GATS, in which Members agreed on the objective of "elaborating upon the provisions of the Agreement with respect to measures affecting access to and use of public telecommunications transport networks and services".[35] The Annex, however, does not oblige Members to make market access commitments in basic telecommunications and thus fails to liberalize trade in telecommunications services. We will take a closer look at the Annex on Telecommunications in Section II.2 below.

Commitments in the telecommunications sector were nonetheless made by Members in 48 of the submitted schedules.[36] 22 of these include some commitments in basic telecommunications, but the scope of commitments is narrow and the terminologies used vary considerably.[37] Most of the commitments by Members were for value-added services. Negotiating market access commitments for value-added services did not face nearly as difficult a process as for basic telecoms because value-added services emerged as a result of more recent technological advancements in telecommunications and were not traditionally provided by national monopolies as basic services were. Value-added services were left to competition while basic services remained heavily regulated. The political difficulties therefore did not exist in the negotiations for value-added services as they did for basic telecommunications.

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35 GATS Annex on Telecommunications, Section 1.

36 WTO, NGBT, Note by the Secretariat, *Negotiations on Basic Telecommunications,* TS/NGBT/W/1, 2 May 1994, para. 9.

37 *Ibid.*

Due to the lack of commitments on basic telecoms, the US suggested an extension of the negotiations on basic telecommunications.[38] The Trade Negotiations Committee at the Ministerial Meeting in Marrakesh on 14 April 1994 adopted the Decision on Negotiations on Basic Telecommunications which established the Negotiating Group on Basic Telecommunications (NGBT) to carry out the negotiations for a further two years after the conclusion of the Uruguay, to close no later than 30 April 1996.[39] The Uruguay Round therefore failed to obtain commitments sufficient to liberalize trade in telecommunications services. It took a further three years to achieve the multilateral framework that now governs the global liberalization of trade in telecommunications, both basic and value-added services.

3. *The Extended Negotiations on Basic Telecommunications*

The objective of the extended negotiations on basic telecommunications, part of the GATT/WTO principle of progressive liberalization, was to secure market-opening commitments from as many countries as possible.[40] Developing countries, however, were hesitant to participate in the extended negotiations on basic telecommunications due to the fact that basic telecommunications services in developing countries were provided by state monopolies. The two largest and most influential developing countries during the Uruguay Round, India and Brazil, for instance did

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[38] Taunya L. McLarty, "Liberalized Telecommunications Trade in the WTO: Implications for Universal Service Policy," 51(1) *Federal Communications Law Journal* (December 1998), p. 17.
[39] Decision on Negotiations on Basic Telecommunications, paras. 3 and 5.
[40] WTO, Press Release, "Next Great Challenge Facing WTO Governments is Liberalization of Trade in Telecommunications – says Director-General Ruggiero", 3 October 1995.

not join the NGBT as participants until its fifth and seventh meeting, respectively.[41]

The extended negotiations on basic telecommunications, which began on 6 May 1994, were on a voluntary basis and covered all basic telecommunications services.[42] Participation, in terms of numbers, however, was low. In the first meeting of the NGBT, which was open to all, only twenty delegations had expressed their intention to participate - a small proportion of the WTO's 123 Members at the time.[43] The number of participants increased to only 27 after more than a year of negotiations, but doubled by the last meeting of the NGBT. For the most part of the two-year negotiations, the number of observing states exceeded the number of active participants: perhaps an indication that most countries were considering with great caution the liberalization of basic telecommunications.

Bilateral negotiations among participants were held, mostly by industrialized countries, alongside the main negotiations conducted by the NGBT. Initially characterized as "positive, productive and useful",[44] disappointments grew over the bilateral meetings and there were calls of urgency in the NGBT for more and better offers of commitments to be

[41] WTO, NGBT, *Report on the Meeting of 27-28 February 1995*, S/NGBT/5, 10 March 1995 (fifth meeting); WTO, NGBT, *Report on the Meeting of 12-13 July 1995*, S/NGBT/7, 17 August 1995 (seventh meeting).
[42] Decision on Negotiations on Basic Telecommunications, paras. 1 and 2. The negotiations thus did not formally include value-added telecoms services.
[43] For subsequent meetings, governments must indicate whether to take part as full participants or as observers. WTO, NGBT, *Report of the Meeting of 6 May 1994*, TS/NGBT/1, 10 June 1994, para. 2.
[44] WTO, NGBT, seventh meeting, S/NGBT/7 (1995), para. 3.

made as well as for the level of participation to increase.[45] Auspiciously, by the end of the negotiations in April 1996, a total of 34 draft offers were received, of which 21 were revised offers. Talks broke down, however, when the US refused to conclude an agreement on basic telecommunications due to the poor quality and lack of commitments by other Members, particularly those of the developing countries.[46] At the time, only the US and ten other governments[47] had made offers to provide unlimited market access in basic telecommunications.[48] This did not cover a "critical mass" of the world telecommunications market and, according to the US, did not therefore provide sufficient effective competitive opportunities for a meaningful agreement.[49]

Despite the breakdown of the negotiations under the NGBT, the results that had been achieved so far were preserved with the adoption of the Fourth Protocol to the GATS along with the list of Schedules of Commitments and lists of Article II Exemptions. The Decision on Commitments in Basic Telecommunications, simultaneously adopted upon the closing of the work of the NGBT and which incorporated the three

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45 See the Reports on the Meetings of the NGBT from 26 January 1996 - 17 April 1996, S/NGBT/12, S/NGBT/13, S/NGBT/14, S/NGBT/15. By the eighth meeting of the NGBT in September 1995, only eight draft offers on basic telecoms commitments had been tabled. The draft offers were received from Australia, Canada, Hong Kong, Japan, Mexico, New Zealand, Slovak Republic, and the US. WTO, NGBT, *Report of the Meeting of 20 September 1995*, S/NGBT/8, 28 September 1995, para. 3. This period coincided with the FCC's adoption of the ECO test which created a two-step 'barrier' process for the entry of foreign carriers into US market; See Chapter 2, Section VI.3.

46 Bronckers and Larouche (1997), p.9; McLarty (1998), p. 18.

47 The other ten governments were Austria, Denmark, Finland, Germany, Iceland, Luxembourg, the Netherlands, New Zealand, Sweden, and United Kingdom. Laura B. Sherman, "Wildly Enthusiastic about the First Multilateral Agreement on Trade in Telecommunications Services", 51(1) *Federal Communications Law Journal* (1998), p. 88.

48 Unlimited market access meant providing open market access for *all* domestic and international services and facilities and allowing 100% foreign investment.

49 McLarty (1998), p. 18.

main objectives made in the Director-General's proposal,[50] established the Group on Basic Telecommunications (GBT) to conduct the extended negotiations until the new deadline of 15 February 1997.[51]

The GBT commenced extended negotiations in July 1996 and decided to open the negotiations to all Members of the WTO.[52] By 15 February 1997, the GBT had achieved significant improvements in market access commitments and in the number of WTO Members adopting the regulatory principles in the Reference Paper. The total number of schedules submitted had increased from 34 in April 1996 to 55 (counting as one the offer of the European Communities and their Member States) at the conclusion of the GBT. Nine governments submitted lists of Article II Exemptions.[53] These schedules and lists of exemptions were attached to the Fourth Protocol in replacement of those attached on 30 April 1996.[54] The Fourth Protocol came into force on 5 February 1998.

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[50] The WTO Director-General, Renato Ruggiero, 'rescued' the negotiations from total failure when, at the last meeting of the NGBT, he made three proposals in his statement to the Group: first, to preserve, as far as possible, the results achieved so far; second, to preserve the economic value of the negotiation by maintaining the implementation date of 1 January 1998; and third, to provide greater flexibility to the talks by allowing a one-month period during which participants could re-examine their positions and supplement or modify their offers to liberalize. WTO, NGBT, *Report on the Meeting of 30 April 1996*, S/NGBT/17, 8 May 1996, para. 2.

[51] WTO, Decision on Commitments in Basic Telecommunications, S/L/19, 30 April 1996.

[52] WTO, GBT, Report of the Group on Basic Telecommunications to the Council on Trade in Services, S/GBT/2, 23 October 1996, para. 5.

[53] They were Antigua & Barbuda, Argentina, Bangladesh, Brazil, India, Pakistan, Sri Lanka, Turkey and the US. The US, for instance, submitted an MFN exemption list on telecommunications services involving one-way satellite transmission of direct-to-home, direct broadcast satellite and digital audio transmission services because it was not satisfied with the quality of commitments made in these areas by other participants. See WTO, *Communication from the United States: List of Article II Exemptions*, S/GBT/W/9, 15 February 1997; Bronckers and Larouche (1997), p. 5 at p. 35. In its initial services offer tabled in the Doha Round on 31 March 2003, the US has removed the MFN exemptions to all these telecommunications services. See the US's Initial Offer, 31 March 2003, p. 112 available at http://www.ustr.gov. On GATS MFN obligation and exemptions, see Chapter 3, Section IV.4. The GATS Annex on Negotiations on Basic Telecommunications allowed Members to legally make Article II exemptions on basic telecommunications that were not listed at the conclusion of the Uruguay Round and before the entry into force of the WTO Agreement.

[54] WTO, Decision on Commitments in Basic Telecommunications, S/L/19 (1996), para. 3.

II. Telecommunications Liberalization through the WTO Discipline

Liberalization of trade in telecommunications services involves the ability of foreign service providers to have access to other WTO Member's domestic telecommunications market. After eleven years of negotiations (1986-1997), the liberalization process of telecommunications services is now incorporated under the WTO multilateral framework. On the signing of the Fourth Protocol to the GATS, 69 governments submitted schedules of specific commitments on basic telecommunications.[55] Today, with the addition of more Members making unilateral or new accession commitments there are a total of 83 governments that have submitted commitments on basic telecommunications, and a total of 70 Members have made commitments in value-added services.[56] This covers more than 90% of the world's telecommunications revenue.[57] Since the date of entry into force of the ABT,

> the vast bulk of the world market, measured in revenue terms, is subject to open markets for the supply of basic telecom services whether on the basis of simple resale or over a supplier's own infrastructure.[58]

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[55] Counting the Member States of the European Communities individually, these governments include: Antigua & Barbuda, Argentina, Australia, Austria, Bangladesh, Belgium, Belize, Bolivia, Brazil, Brunei Darussalam, Bulgaria, Canada, Chile, Colombia, Cote d'Ivoire, Czech Republic, Denmark, Dominica, Dominican Republic, Ecuador, El Salvador, Finland, France, Germany, Ghana, Greece, Grenada, Guatemala, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Korea, Luxembourg, Malaysia, Mauritius, Mexico, Morocco, the Netherlands, New Zealand, Norway, Pakistan, Papua New Guinea, Peru, Philippines, Poland, Portugal, Romania, Senegal, Singapore, Slovak Republic, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Trinidad & Tobago, Tunisia, Turkey, United Kingdom, United States, Venezuela.

[56] WTO website at http://www.wto.org/english/tratop_e/serv_e/telecom_commit_exempt_list_e.html and WTO, CTS, S/C/W/74, para. 19.

[57] WTO, News, "Ruggiero congratulates governments on landmark telecommunications agreement", Press/67, 17 February 1997.

[58] WTO, CTS, *Telecommunication Services*, Background Note by the Secretariat, S/C/W/74, 8 December 1998, para. 5.

The WTO now governs an industry with an estimated market revenue that totaled $1,010 billion (US) in 2001.[59]

Although over half of the WTO Members have made commitments to open some or all basic telecommunications services to foreign competition, not all are opening their markets at the same time. About 40%, have subjected their commitments to a phase-in period.[60] This means that while the schedule of a Member formally entered into force on the date of entry into force of the Fourth Protocol as a whole, the actual implementation will be on the date specified in the schedule. Thailand, for example, will liberalize mode 3 market access of its public telecommunications services in 2006.[61] Meanwhile, Barbados will take until 2012, when monopoly exclusivity expires, before it liberalizes voice telephony, data transmission and private leased circuit services offered to the general public.[62] It is mainly developing countries which have limited their commitments through phasing-in.

1. *Liberalizing Telecoms through Regulatory Principles: the Reference Paper*

The most significant product of the extended negotiations is the Reference Paper, a set of pro-competitive principles on the regulatory framework for basic telecommunications services.[63] It is unique: no other WTO agreement has a similar set of sector-specific principles to discipline

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[59] ITU at http://www.itu.int/ITU-D/ict/statistics/at_glance/KeyTelecom99.html.
[60] WTO website at
http://www.wto.org/english/tratop_e/serv_e/telecom_highlights_commit_exempt_e.html.
[61] WTO, Trade in Services, "Thailand: Schedule of Specific Commitments, Supplement 2", GATS/SC/85/Suppl. 2, 11 April 1997.
[62] WTO, Trade in Services, "Barbados: Schedule of Specific Commitments, Supplement 1", GATS/SC/9/Suppl.1, 24 February 1998.
[63] For the full text of the Reference Paper, see Appendix V.

domestic regulatory policies. Not even the financial services sector, comparable to telecommunications due to its dual role as tradable services in its own right and as an underlying means for trade, obtained such a set of regulatory principles as the Reference Paper during similar extended negotiations on financial services in the WTO after the Uruguay Round.

It was recognized earlier on in the negotiations on basic telecommunications that a development of a set of safeguards against anti-competitive practices was needed in order to achieve the objective of liberalizing the telecommunications sector.[64] These safeguards would ensure that monopolies or dominant suppliers of basic telecommunications could not exploit their dominant positions to distort market forces and impede the ability of competitors to supply networks or services covered by the new commitments. In addition, the primary characteristic of trade in telecommunications services is that it takes place predominantly through the interconnection and interoperability of national telecommunications systems. The ability to interconnect with public switched networks thus becomes a crucial element of enabling market access by foreign suppliers.

The process of drafting the Reference Paper began in February 1995 during the extended negotiations[65] with the US distribution of a paper entitled, "Pro-competitive Regulatory and Other Measures for Effective Market Access in Basic Telecommunications Services".[66] The paper addressed four regulatory issues: interconnection of competing basic

[64] WTO, NGBT, Note by the Secretariat, *Review of Outstanding Issues*, TS/NGBT/W/2, 8 July 1994, para. 15.
[65] WTO, NGBT, fifth meeting, S/NGBT/5 (1995), para. 6.
[66] WTO, NGBT, Communication from the United States, S/NGBT/W/5, 9 February 1995 (*US: Pro-Competitive Measures*). The US brought to the WTO its experience in the regulation of telecommunications. In its communication, the US stated: "The experience of the United States, in moving its domestic regime from monopoly to the competitive supply of basic telecommunications services, has made clear the need for a pro-competitive regulatory system." *Ibid.*, p. 1.

telecommunications supplier; competitive safeguards on dominant service suppliers; transparency of regulatory processes; and the independence of regulators.[67] The US negotiators later convened a meeting of selected delegates to begin dialogue on these high-lighted regulatory objectives.[68] This select group met regularly thereafter, and assisted by the contributions of the US, Canada, Australia and the EC, Japan developed a composite set of regulatory principles in October 1995 for discussion by the Room A Group,[69] and circulated a non-paper in the NGBT at its eleventh meeting on 15 December 1995. This non-paper became known as the Reference Paper.

The Reference Paper, however, did not have legal status *per se*. It was to be used as a guideline for the scheduling of additional commitments.[70] Only what was explicitly inscribed in the schedule of commitments would be legally binding.[71] Thus, if a Member wished to be bound by the principles drafted out in the Reference Paper, they can inscribe these under the additional commitments column of its national schedule. Although the Reference Paper was never formally adopted as a WTO document, at the conclusion of the basic telecommunications negotiations, 63 governments inscribed commitments on regulatory disciplines in the additional commitments section of their schedules; and 57 of these committed to the Reference Paper in its entirety or with a few

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[67] WTO, *US: Pro-Competitive Measures*, S/NGBT/W/5, (1995).
[68] Sherman (1998), p. 71.
[69] This group was known as the "Room A Group," after the room at the WTO where it first met. Subsequent meetings, informally chaired by the chief Japanese delegate to the NGBT, met at the Japanese Embassy. Initial participants represented the US, Australia, New Zealand, Japan, Korea and the EC. Participants from Brazil, Singapore, Chile, Mexico and the Philippines joined the original participants in later sessions. Sherman (1998), p. 71.
[70] WTO, NGBT, *Report on the Meeting of 22 March 1996*, S/NGBT/14, 29 March 1996, para. 5. The Chairman of the NGBT described the Reference Paper as "a tool to help participants arrive at an understanding of the kinds of commitments they might undertake on regulatory matters." WTO, NGBT, *Report on the Meeting of 26 January 1996*, S/NGBT/12, 14 February 1996, para. 6.
[71] WTO, S/NGBT/14, para. 5.

modifications.[72] As with any commitments listed in a Member's schedule, the commitments to the Reference Paper are subject to the dispute settlement system of the WTO. This is one of the remarkable achievements of the extended negotiations on basic telecommunications.

The Reference Paper, with its regulatory disciplines which define the role of the regulator vis-a-vis the incumbent telecommunications operators, is the key to promoting and maintaining a competitive telecommunications market. These disciplines, set out in six sections, detail the principles on competitive safeguards, interconnection, universal service, public availability of licensing criteria, independent regulators, and the allocation and use of scarce resources. The three core principles on anti-competitive safeguards, interconnection and establishment of an independent regulator are designed to ensure that the advantages of the former monopoly operator are not used to the detriment of new entrants to the telecommunications markets, and that competition and interconnection obligations are enforced. As it is, it is exceedingly difficult for new entrants to gain sufficient market share, particularly in relation to access to the final customer[73] and the provision of fixed local service generally.[74] In the UK, for example, the incumbent operator British Telecommunications (BT) made the situation of its would-be rivals as difficult as possible, so that many gave up.[75] Effective regulatory safeguards, especially in relation to competition and interconnection, are indispensable.

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[72] WTO website at:
http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_history_e.html.
[73] To recall, this access to the final customer is also known as the "local loop", see Chapter 2, Section V.1(b).
[74] WTO, *Telecommunication Services*, S/C/W/74, para. 30.
[75] *The Economist*, "Broadband: the Price is Wrong", 24-30 November 2001, p. 37.

(a) Competitive Safeguards

Section 1 of the Reference Paper contains competitive safeguards. It states that appropriate measures should be maintained for the purpose of preventing major suppliers from engaging in or continuing anti-competitive practices. An illustrative, though not exhaustive, list of anti-competitive practices is in Section 1.2 of the Paper. Engaging in anti-competitive cross-subsidization is one example.

A criticism of this provision of the Reference Paper is that for cross-subsidization to be effectively prevented, an appropriate regulatory framework must be developed whereby the major supplier in question creates separate subsidiaries with independent administration and accounting operations, with regular reporting and disclosure requirements.[76] The Reference Paper, however, does not provide for such a requirement.

If the Reference Paper appears brief, it is due to its drafting history during the negotiations. This concise document on regulatory principles was drawn up to provide a guideline to Members making domestic regulatory policies. From the beginning the Reference Paper did not refer to obligations of a "WTO Member" because the negotiators decided they were developing a "reference paper" and not something binding on any Member.[77] As a result, negotiators wrote the Reference Paper in the passive voice without any indication as to who was to carry out the obligations.

[76] Bronckers and Larouche (1997), p. 27; Fredebeul-Krein and Freytag (1997), p. 489.
[77] Sherman (1998), p. 72.

Some see this as a weakness,[78] but others have pointed to the strength in adopting such flexibility.[79] This flexibility was necessary due to the different regulatory regimes of each Member. New Zealand, for example, did not have a separate telecommunications regulator, and its representative during the NGBT thus objected to efforts to have the document of the Reference Paper refer to a "regulator" as the responsible entity.[80] The guideline approach in the Paper was aimed at striking a balance between the two objectives of international market openness and national sovereignty.[81]

(b) Interconnection

The second section of the Reference Paper on interconnection disciplines is the core of the Paper. Allowing non-discriminatory interconnection is vital to the liberalization and opening up of telecommunications markets. New entrants in the market need to be able to link to the incumbent's networks in order to provide services to their customers, as new entrants would not yet have enough rolled-out networks. Interconnection is a matter of

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[78] See, for example, Bronckers and Larouche (1997); Fredebeul-Krein and Freytag (1997); Fredebeul-Krein and Freytag, "The Case for a More Binding WTO Agreement on Regulatory Principles in Telecommunications Markets," 23 *Telecommunications Policy* (1999), pp. 625-644.

[79] See C. Blouin, "The WTO Agreement on Basic Telecommunications: a reevaluation", 24 *Telecommunications Policy* (2000), p. 135.

[80] Sherman (1998), p. 72. See Section II.1(e) below on independent regulators.
New Zealand had no sector-specific regulatory body for telecoms since the industry's deregulation in 1987 by the enactment of the Telecommunications Act 1987. The only 'regulation' of the industry was through effective competition, to be secured through the application of the 1986 Commerce Act. New Zealand preferred this light-touch approach and generally re-regulation was unwarranted. However, regulation and an independent telecoms regulator were re-introduced to New Zealand's telecoms industry by the adoption of the Telecommunications Act 2001 which has as its stated purpose "to regulate the supply of telecommunications services" (S. 3(1) 2001 Act). The Telecommunications Act 2001 is available on the New Zealand government's website at http://www.legislation.govt.nz/browse_vw.asp?content-set=pal_statutes. For further reading, see J. Laffont and J. Tirole, *Competition in Telecommunications* (2001), pp. 33-34; C. Long, *Telecommunications Law and Practice*, (1995), Chapter 26, pp. 564-589.

[81] C. Blouin (2000), at p. 140.

commercial negotiation between the parties concerned, and the incumbent telephone operator holds the power to interconnect.

The Reference Paper provisions on interconnection, which are more specific than those on competitive safeguards, set out to ensure telecommunications suppliers are able to link with one another,

> in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier.[82]

The disciplines on interconnection in the Reference Paper broadly reflect the most recent legislative efforts in the US and the EC.[83] Section 2 of the Reference Paper contains the core principles of non-discrimination, transparency, reasonable terms and conditions and cost-oriented rates.

The provision's transparency requirement entail that the procedures for interconnection to a major supplier must be made publicly available. Major suppliers should also make publicly available either their interconnection agreements or a reference interconnection offer. This provides a competitive and informed environment for telecommunications suppliers negotiating the terms and conditions of their interconnection

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[82] Section 2.1 Reference Paper.

[83] See also Chapter 2. For US legislation on interconnection, see Sections 251 and 252 of the 1934 Communications Act, as amended, (47 U.S.C. 251 and 47 U.S.C. 252 respectively). The elements of non-discrimination, transparency and cost-oriented rates central to Section 2 of the Reference Paper were also found in the EC Directive on Interconnection (Directive 97/33/EC) that was part of the old EC regulatory framework on telecommunications liberalization. Furthermore, the EC Interconnection Directive likewise had a provision to deal with the settlement of disputes over interconnection issues. See Directive 97/33/EC, OJ L 199/32, 26 July 1997 (Interconnection Directive), in particular Articles 1, 2, 6, 7 and 17. The new and current EC telecoms regulatory framework replaced the Interconnection Directive with the Access Directive which has its application extended to include not only basic telecommunications services but also cable television, broadcasting, satellite and Internet Protocol networks. The Access Directive builds on the principles set out in the previous Interconnection Directive (97/33/EC) and the TV standards Directive (95/47/EC). It establishes rights and obligations for operators and for undertakings seeking interconnection and/or access to their networks or associated facilities. It also sets out the objectives for national regulatory authorities (NRAs) with regard to access and interconnection. Like in the previous framework, the NRAs are given powers under the new Access Directive to intervene to resolve disputes, but they are given more pro-active powers to intervene in order to impose obligations on market players. The Directive continues the important theme of the basic principles of transparency, non-discrimination and objectivity. See Directive 2002/19/EC, OJ L 108/7, 24 April 2002 (Access Directive), in particular Articles 5, 9, 10 and 12.

agreements. Furthermore, the Reference Paper interconnection provisions require that interconnection with a major supplier at any technically feasible point in the network to be provided under non-discriminatory terms. To achieve this, network operators are also required to unbundle network components, to disclose information on technical standards, and to guarantee the quality they provide for their own services.

Finally, consistent with the US and EC legislation on interconnection, the Reference Paper also provides that dispute settlement mechanisms be available to resolve disputes regarding appropriate terms, conditions and rates for interconnection.[84] It does not, however, further elaborate on what constitutes "resolving" the dispute, i.e. whether a settlement can be imposed on the parties or not.[85]

(c) Universal Service

Section 3 of the Reference Paper covers universal service. This provision does not provide any definition of parameters for universal service. Members are left to define freely the kind of universal service obligation they wish to maintain. The phrase "such obligations will not be regarded as anti-competitive *per se*" was in response to India's concern that any universal service system could be attacked as anti-competitive regardless of the way it was implemented; the Reference Paper was not intended to limit the scope of universal service obligations.[86] The right to maintain domestic policies on universal services is of particular concern for developing countries whose telecommunications industry still requires

[84] See EC Interconnection Directive (97/33/EC) and Access Directive (2002/19/EC); See also Section 252 of the Communications Act of 1934, as amended, (47 U.S.C. 252).
[85] Bronckers and Larouche (1997), p. 30.
[86] Sherman (1998), p. 84.

continued development of needed infrastructure and the roll-out of affordable telecoms services in particular to the more deprived rural areas.

(d) Public Availability of Licensing Criteria

Section 4 of the Reference Paper provides for the transparency of government regulation on licensing by providing that all licensing criteria and the terms and conditions of individual licenses be made publicly available. An applicant is also entitled to the reasons for denial of a license upon request. It is believed that this transparency requirement for licensing will have considerable effect on the opening of telecommunications markets.[87]

(e) Independent Regulators

The rules dealing with independent regulators are one of the most important elements, along with competitive safeguards and interconnection, of the regulatory principles. This is particularly so from the US perspective. To recall, the modern form of state regulation, whereby the operation of the telecommunications industry is predominantly left to market forces but is also overseen by an independent government regulator, originated in the US.[88] The US historical experience in independent regulation began in the late nineteenth century when the Interstate Commerce Commission regulated long-distance telecommunications prior to the enactment of the 1934 Communications

[87] Fredebeul-Krein and Freytag (1997), p. 490.
[88] See Chapter 2.

Act and the establishment of the FCC, and continues into the competition era today.[89] Meanwhile in Europe, where regulatory experience is behind the US, the UK was the first to create a telecommunications independent regulator in 1984 and at the European level, the concept of independent regulators for telecommunications did not emerge until the adoption of the Leased Lines Directive in 1992.[90] There has been evolution from the necessity for an independent regulator to govern a natural monopoly to the independent regulator tasked with the duties to promote competition. This trend, evident in developed countries, is growing constantly even among developing countries.

The fifth section of the Reference Paper sets out in two sentences the discipline for an independent regulator. WTO Members who have made full commitments on the Reference Paper must guarantee the separation of the regulatory authority from any supplier of basic telecommunications services.[91] The independent regulatory bodies must also be impartial with respect to all market participants. Although GATS Articles VI and VIII provide general rules covering Domestic Regulation and Monopolies and Exclusive Service Suppliers respectively, the US drew attention to the importance of additional commitments to ensure the effective independence of the regulator, particularly in basic telecommunications.[92] This Reference Paper discipline is intended to safeguard against potential situations of conflict of interests, for instance where governments are owners of the incumbent telecoms operator. This Reference Paper

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[89] *Ibid.*
[90] Council Directive 92/44/EEC of 5 June 1992, OJ L165/27, 19 June1992. Under the EU framework on telecoms, independent regulators, known as national regulatory authorities (NRAs), have the duty to monitor the implementation and functioning of EC regulatory legislation on telecommunications; there is no central European regulatory authority.
[91] A point to note is that the provision does not require that the regulator be independent of any government ministry. Sherman (1998), p. 86.
[92] WTO, *US: Pro-Competitive Measures*, S/NGBT/W/5 (1995), p. 4.

provision calling for countries to establish autonomous regulators is thus crucial to the liberalization and competition of telecommunications markets.[93]

(f) Allocation and Use of Scarce Resources

The last section of the Reference Paper covers the allocation and use of scarce resources stating:

> Any procedure for the allocation and use of scarce resources, including frequencies, numbers and rights of way, will be carried out in an objective, timely, transparent and non-discriminatory manner.

Rules on the actual policies of allocating these resources are not, however, provided by this provision. It requires that the current state of allocated frequency bands are made publicly available, but for national security reasons, detailed identification of frequencies allocated for specific government uses is not required.

The strengths of the Reference Paper lie in its "guideline structure" and its flexibility. Some, however, have criticized it as vague and lacking in precision.[94] This criticism fails to appreciate the very reasons for the intended "lack of precision" by the drafters. On the contrary, the provision on interconnection, for instance, is detailed for a set of principles meant to be a "guideline" on regulatory disciplines. Moreover, the interconnection provision, as well as the rest of the Reference Paper, is essentially a

[93] In the *Mexico-Telecommunications* case, for instance, the US alleged that the Mexican independent telecoms regulator, Cofetel, was not effective in controlling the incumbent Telmex's powers and ensuring a competitive environment in Mexico's telecommunications market. See Section III below.
[94] See Bronckers and Larouche (1997).

transplantation of US and EC legislation on telecommunications.[95] In both the regulatory regimes of the US and the EC, the frameworks are drafted in a manner to allow scope for the relevant regulatory authorities to hammer out the details. In similar fashion, the Reference Paper is intended as a set of guideline principles whereby WTO Members who have committed to them are left to legislate domestically on basic telecommunications consistently with their WTO commitments.

The flexibility that characterizes the Reference Paper is more importantly an acknowledgment of,

> the right of Member States to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right.[96]

WTO Members, particularly developed countries including the US and the EC, although desiring these additional commitments on regulatory principles to ensure effectiveness of market access commitments, nonetheless recognize the need to retain flexibility and allow countries to provide their own details on basic regulation.[97] In many cases, the provisions in the Reference Paper draw upon the principles set out in

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[95] See Chapter 2, and Section II.1(b) of this Chapter.

[96] GATS *Preamble*. This WTO recognition of the right of Members to regulate their domestic policies on telecommunications, where necessary, can also be found in the Annex on Telecommunications, Section 5(e) and (f). Section 3 of the Reference Paper, for instance, recognizes the right of Members to regulation of their domestic policies on universal service.

[97] See WTO, NGBT, *Report on the Meeting of 22 March 1996*, S/NGBT/14 (1996), para. 5, where delegates have stressed that regulatory principles as proposed in the Reference Paper "should take into account the different stages of liberalization and that the varied nature of the regulatory systems and structures of each country required that a flexible and gradual approach should be adopted". Flexibility was also intended to ensure that developing countries would not be discouraged from taking on such regulatory commitments. See WTO, NGBT, S/NGBT/12 (1996), para. 6.

GATS Article VI:4[98] and add greater specificity or, in some instances, may expand upon the existing coverage and scope of Article VI.[99]

In the current negotiations on trade in services, as part of the Doha Round, Members have been tabling proposals on trade in services, including telecommunications. Australia, the US and the EC, for instance, have made proposals on improving and strengthening the Reference Paper. Proposals included the following: that all Members adopt the Reference Paper in full; that meaningful WTO commitments on telecommunications require full adherence to pro-competitive regulatory principles contained in the Paper; and that the Reference Paper should be strengthened through clarification of its provisions on competitive safeguards, interconnection, transparency, the independence of regulators and the allocation of resources.[100] At the end of 2004, there has been no indication of a revised Reference Paper and Members who have fully committed to the Reference Paper in the previous round of negotiations have attached to their initial services offers tabled in the WTO in March 2003[101] the same set of regulatory disciplines contained in the Reference Paper drawn up in the NGBT.[102]

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[98] These principles are transparency, objectivity and necessity.

[99] Lee Tuthill, "The GATS and New Rules for Regulators", 21(9/10) *Telecommunications Policy* (1997), p. 783 at 789-790.

[100] See WTO, CTS (Special Session), Communication from Australia, *Negotiating Proposal for Telecommunication Services*, S/CSS/W/17, 5 December 2000; WTO, CTS (Special Session), Communication from the United States, *Market Access in Telecommunications and Complementary Services: the WTO's Role in Accelerating the Development of a Globally Networked Economy*, S/CSS/W/30, 18 December 2000; WTO, CTS (Special Session), Communication from the European Communities and their Member States, *GATS 2000: Telecommunications*, S/CSS/W/35, 22 December 2000; WTO, CTS (Special Session), Communication from Switzerland, *GATS 2000: Telecommunications*, S/CSS/W/72, 4 May 2001.

[101] As mandated by the WTO *Guidelines and Procedures for the Negotiations of Trade in Services*, S/L/93, 29 March 2001, para. 11; and agreed at the WTO Ministerial Conference in Doha in November 2001 (WTO, *Ministerial Conference, Fourth Session, Ministerial Declaration*, adopted 14 November 2001, WT/MIN(01)/DEC/1, 20 November 2001, para. 15).

[102] See, for example, the US Initial Offer submitted to the WTO on 31 March 2003, available at http://www.ustr.gov; (see Appendix VI), and the EC Initial Offer submitted to the WTO on 29 April 2003, at http://europa.eu.int/comm/trade/services/pr290403_en.htm.

The Fourth Protocol package, including the Reference Paper, provides an indispensable set of multilateral framework and regulatory principles to promote the liberalization of telecommunications services. But it must be recalled that although the Fourth Protocol is an agreement specific to the telecommunications sector, trade in telecommunications services are also subject to all the obligations and disciplines of the GATS which have been discussed extensively in the previous chapter. Moreover, Members still incur the obligations contained in the Annex on Telecommunications concluded in the Uruguay Round.

2. *Annex on Telecommunications*

The GATS Annex on Telecommunications is the result of the negotiations on telecommunications during the Uruguay Round. Although the contents of the Annex were discussed during the WGTS as part of its mandate, it was the US who in 1990 originally made the proposal for an annex.[103] While the US emphasized the necessity of an annex on telecommunications,[104] some parties, like Chile, did not see the need, their argument being that the multilateral framework on trade in services being negotiated would cover the issues in this service sector.[105]

The Annex on Telecommunications establishes the right of Members to make use of public telecommunications networks and services. The Annex applies to,

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[103] GATT, *Communication from the United States: Annex, Access to and the Use of Public Telecommunications Transport Services*, MTN.GNS/W/97, 23 March 1990.
[104] GATT, WGTS, MTN.GNS/TEL/4, (1990), para. 11.
[105] GATT, WGTS, MTN.GNS/TEL/2, para. 110; see also Section I.1 above.

all measures of a Member that affect *access to and use of* public telecommunications transport networks and services.[106] (emphasis added)

The main objective is to ensure that Members can have access to and use of public telecommunications transport networks and services of other Members for the supply of trade in services. The Annex, however, leaves open whether "access to and use of" also covers "interconnection". In technical terms on telecommunications, a difference is usually made between interconnection and access. As an example, in the EU communications framework "access" is defined in the Access Directive as,

the making available of facilities and/or services, to another undertaking, under defined conditions, on either an exclusive or non-exclusive basis, for the purpose of providing electronic communications services. It covers *inter alia*: access to network elements and associated facilities, which may involve the connection of equipment, by fixed or non-fixed means (in particular this includes access to the local loop and to facilities and services necessary to provide services over the local loop), access to physical infrastructure including buildings, ducts and masts; access to relevant software systems including operational support systems, access to number translation or systems offering equivalent functionality, access to fixed and mobile networks, in particular for roaming, access to conditional access systems for digital television services; access to virtual network services.[107]

There is a separate definition for "interconnection" in the same Directive which describes interconnection as,

the physical and logical linking of public communications networks used by the same or a different undertaking in order to allow the users of one undertaking to communicate with users of the same or another undertaking; or to access services provided by another undertaking. Services may be provided by the parties involved or other parties who have access to the network. Interconnection is *a specific type of access implemented between public network operators.*[108] (emphasis added)

From this definition on interconnection, the EU describes interconnection as a type of access specific to *public network operators*. Thus,

[106] GATS Annex on Telecommunications, Section 2(a). In the footnote to this provision, it states: "This paragraph is understood to mean that a Member shall ensure that the obligations of this Annex are applied with respect to *suppliers* of public telecommunications transport networks and services *by whatever means are necessary*" (emphasis added). See Appendix I.
[107] Access Directive (2002/19/EC) Article 2(a).
[108] Access Directive (2002/19/EC) Article 2(b).

interconnection would not be used to describe the situation whereby a customer is connected to the public telecommunications network at a termination point, such as a phone, or to use the services provided generally by telecommunications operators. On the other hand, interconnection applies to public telecommunications operators being able to connect - physically and logically link - their networks with one another.[109]

Although the Annex contains the obligation to allow WTO Members access to one another's public telecommunications networks, it does not open up telecommunications markets to competition from foreign suppliers. Its impact on liberalizing national telecommunications market is therefore limited as it does not oblige Members to make market access commitments in basic telecommunications.[110] It must be recalled that the stated objective of the Annex, unlike the ABT, is not to open up telecommunications markets.[111] Liberalization *per se* was never the intended goal for the Annex, not even during the negotiations on telecommunications in the Uruguay Round.[112]

Nonetheless, the Annex guarantees that suppliers of services of WTO Members will have fair and non-discriminatory access to public telecommunications networks and services that they need in order to carry out their business, which is the supply of services as specified in Members' schedules.[113] This obligation is contained in the seven paragraphs of Section 5 of the Annex on Telecommunications, and

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[109] See also Chapter 2; and US Code of Federal Regulations, Title 47, 47 CFR Ch. 1 Section 51.5 (October 1, 2003 edition), available at http://wireless.fcc.gov/rules.html.
[110] Frdebeul-Krein and Freytag (1997), p. 485.
[111] See GATS Annex on Telecommunications, Section 1.
[112] See notes on the Uruguay Round meetings on telecommunications: GATT, WGTS, MTN.GNS/TEL/1; GATT, WGTS, MTN.GNS/TEL/2; GATT, WGTS, MTN.GNS/TEL/3; GATT, WGTS, MTN.GNS/TEL/4; GATT, GNS, *Note on the Meeting of 10-25 July 1991*, MTN.GNS/44, 28 August 1991, paras. 31-42.
[113] GATS Annex on Telecommunications, Section 5.

provides the core of the Annex. The Section 5 obligation applies only for the supply of a service included in a Member's schedule. For example, where a Member has listed architectural services in its schedule of commitments that Member must ensure that another Member wishing to supply architectural services to its country is "accorded access to and use of public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions" for the supply of that other Member's architectural services.[114] In this scenario, even though the Annex does not guarantee the right to provide and supply public telecommunications networks and services, if basic telecommunications services are inscribed in a Member's schedule, it follows that there is an obligation by that Member to accord reasonable and non-discriminatory access to and use of its public telecommunications networks and services for the supply of basic telecommunications by other WTO Members.[115] The Annex does therefore have some power to effect liberalization of trade in telecommunications services.

However, since the conclusion of the ABT, it has been said that the Annex on Telecommunications has lost some significance.[116] Nonetheless, the Annex still remains relevant to telecommunications services in three main situations. The first is when a given WTO Member has not made any commitments under the Fourth Protocol.[117] Even if a Member does not commit in its schedule to liberalize telecommunications services, it must nonetheless guarantee the use and access of its public

[114] GATS Annex on Telecommunications, Section 5(a).
[115] The Panel decision in *Mexico-Telecommunications* takes this interpretive approach to Section 5 Annex. See Section III.4(f) below.
[116] Broncker and Larouche (1997), p 32.
[117] *Ibid.*

telecommunications transport networks and services as underlying transport services for other services.

A second situation is when a given WTO Member has made commitments under the Fourth Protocol but has not or not fully committed itself to the principles in the Reference Paper.[118] The Annex could provide some protection to suppliers of basic telecommunications. Because even if a Member has not committed itself to the Reference Paper but has nonetheless committed to basic telecommunications in its schedule, the Annex obliges that Member to allow access to and use of its public telecommunications networks and services by a basic telecommunications supplier of another Member.

A third situation where the Annex is relevant to the liberalization of telecommunications services is with respect to suppliers of value-added telecommunications services whose governments have made commitments on these services.[119] The Reference Paper only applies to basic telecommunications services, so value-added service suppliers will have to rely on the regulatory principles contained in the Annex.

In the next section we examine the first WTO dispute settlement case on telecommunications, applying the analyses undertaken in this and the previous chapters on the GATS, the Annex on Telecommunications and the ABT, in particular the Reference Paper on pro-competitive regulatory principles.

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118 *Ibid.*

119 *Ibid.*

III. WTO Dispute Settlement on Telecommunications Services: US v Mexico

Under Section 1377 of the Omnibus Act 1988, the Office of the United States Trade Representative (USTR) conducts annual reviews of foreign countries' compliance with international trade agreements, such as the WTO agreements. Through its Section 1377 review, the USTR each year identifies countries believed to restrict market access of telecommunications services and urges these countries to fulfill their responsibilities to address the problems highlighted by the USTR. The Act authorizes the USTR to take action against any country determined to be conducting unfair trade practices in the telecommunications sector. One country that had consistently been on the USTR review list of persistent violators was Mexico. The US took the decisive step of compelling Mexico to address its telecommunications trade commitments by bringing a case against it in the WTO dispute settlement system.[120]

1. *Events Leading Up to Dispute Resolution in the WTO*

The US action against Mexico on telecommunications began in 1997 when the US Trade Representative, Charlene Barshefsky, announced that the US would move aggressively against Mexico's former monopoly telecommunications supplier, Teléfonos de Mexico, S.A. de C.V. (Telmex), in an effort to pry open its monopolistic hold on the telecommunications

[120] WTO, *Mexico – Measures Affecting Telecommunications Services*, Panel Report, WT/DS204/R, adopted 1 June 2004. Hereinafter *Mexico-Telecommunications*.

sector in Mexico. Mexico had committed to liberalize its telecommunications market when it signed up to the North American Free Trade Agreement (NAFTA) that entered into force on 1 January 1994. Mexico further promised to open up its basic telecommunications market when, in February 1997, it signed the GATS Fourth Protocol and scheduled the full Reference Paper as additional commitments. But by 2000, Telmex was still abusing its monopoly power to restrict competition and the Mexican regulator Cofetel seemed unable to efficiently challenge Telmex's behaviour. Eventually these events led the US to bring charges against Mexico to the WTO dispute settlement system.

The case against Mexico is extremely important to the US telecommunications industry because Mexico is the US's biggest market for exports of its telecommunications services: US carriers sent 5.5 billion minutes of telephone calls from the US to Mexico in 2000 – the world's largest one-way international traffic on any route.[121] And according to the US, Mexico's violations of its WTO commitments cause the US to lose over $500 million in potential trade each year.[122]

2. *The Mexican Telecommunications Industry*

Telmex is Mexico's incumbent telecommunications operator. It was formed in December 1947 as a private company. Over the years it developed into a powerful Mexican corporation with strong political ties.

[121] FCC, *2000 Section 43.61 International Traffic Data Report*, December 2001, Table A1, http://www.fcc.gov/wcb/iatd/intl.html; also *Mexico - Measures Affecting Telecommunications Services*, First Written Submission of the US, 3 October, 2002, WT/DS204, paragraph 4 (*US First Written Submission*).
[122] USTR, *2003 National Trade Estimate Report on Foreign Trade Barriers*, 31 March 2003, p. 278. (*2003 Trade Barrier Report*).

In 1972, the Mexican government acquired 51% share of Telmex and nationalized it in March 1976.

In 1990, Telmex was privatized with the selling of fifty-one per cent share to strategic alliances with international entities. The concession was awarded for fifty-one years and granted a virtual monopoly for six years. After its privatization, Telmex underwent periods of serious modernization of its service infrastructure, dropping the waiting period for installing telephone lines from up to 2 years in 1990 to about 27 days in 1999. Telmex's financial performance places it among the top technology companies in the world.[123]

In the 1990s, the government established two new executive agencies to monitor and regulate the anticipated growth in the sector: the Federal Competition Commission (CFC),[124] established in June 1993, which has oversight over companies that may be engaging in monopolistic practices, and the Federal Telecommunications Commission (Cofetel),[125] Mexico's independent telecommunications regulatory authority established under the Federal Telecommunications Law of 1995 (FTL) on 9 August 1996.[126] The FTL, enacted to coincide with Mexico's entrance into full participation in the NAFTA, provides the legal framework for Mexico's telecommunications regulation. It superseded nearly all laws and regulations formerly governing the telecommunications sector and

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123 Luz Nagle, "Anti-trust in the International Telecommunications Sector", 33 U. Miami Inter-Am.L.Rev. (2002), p. 183 at 191; Elizabeth Malkin, "Mexico's 800 Pound Gorilla", *Business Week*, 18 June 2001, at 113.

124 Comisión Federal de Competencia.

125 Comisión Federal de Telecomunicaciones.

126 Federal Telecommunications Law ("Ley Federal de Telecomunicaciones"), published in the Federal Gazette ("Diario Oficial de la Federación") on 7 June 1995, entered into force on 8 June 1995.

includes almost all aspects of the telecommunications industry.[127] The WTO case against Mexico stemmed from, among others, the FTL 1995.

Similar to the US FCC, Cofetel is charged with both implementing the FTL and promulgating regulations based upon the FTL. Unlike the FCC, however, Cofetel is located wholly within the executive branch of the government, being an administrative unit of the Secretariat of Communications and Transportation (SCT),[128] although enjoying technical and operational autonomy. In addition, Cofetel must work closely with the SCT on competition policy and licensing matters. Cofetel has assumed much of the duties originally assigned to the SCT, but the SCT has exclusive power to issue permits and concessions to install, establish, operate and exploit networks, stations and telecommunications services. For the first few years, many considered Cofetel a powerless and ineffectual body that more often than not turned a blind eye on Telmex's attempts to dominate the telecommunications sector.[129]

Mexico began to introduce competition into its telecommunications industry during the 1990s, with foreign competition entry permitted after 10 August 1996. The careful transition from privatization to competition of the Mexican telecommunications industry was in many ways a textbook example of reform.[130] There remain, however, at least three significant problems as competition got underway: 1) the problems with the Mexican regulatory process, 2) rate rebalancing and 3) interconnection policy.[131]

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[127] The FTL superseded the Law of General Routes of Communications 1939, Communications Law 1940 and the Telecommunications Regulations of 1990.

[128] Secretaría de Comunicaciones y Transporte.

[129] Nagle (2002), p. 183 at 207.

[130] Peter Cowey and Mikhail M. Klimenko, *The WTO Agreement and Telecommunications Policy Reforms*, World Bank Policy Research Working Paper, Report No. WPS 2601, 31 May 2001, p. 40.

[131] *Ibid.*

These very issues were the bases of the US complaint against Mexico in the WTO dispute settlement system, as will be seen.

3. Competition and Business with the US

The Mexican government ended Telmex's monopoly concession for domestic and international long-distance services on 1 January 1997, when 6 entrants initiated service in 60 of Mexico's largest cities. Local services opened to competition on 29 December 1998. Telmex's primary long-distance competitors are Avantel and Alestra. MCI WorldCom (now MCI) – a US telecoms firm – has a forty-five percent stake in Avantel, and Alestra is forty-nine percent owned by AT&T. Since 1996, when the two companies entered the long-distance market, Alestra and Avantel together have taken over thirty percent of the long-distance market from Telmex.[132] Telmex, however, still retains control of around 97% of the local telecommunications market.[133] It continues to dominate long-distance service, as well as Internet service and other aspects of Mexico's $12 billion telecommunications market.[134]

The introduction of foreign competition to Mexico's telecommunications market in 1997 prompted Telmex to reduce its connection fee by half. The new rate, however, was still high and since then the US applied pressure on the Mexican government to compel Telmex to further reduce the rate. Telmex had agreed to comply with the

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[132] Nagle (2002), p. 233. Since 2000, however, Telmex has increased its share of the Mexican domestic long-distance market and is now reported to control roughly 90% of Mexico's lines; *Mexico – Telecommunications*, Second Written Submission of the US, February 5, 2003, para. 10 (*US Second Written Submission*); see also Dow Jones Business News, *Mexico's Antitrust Commission Rules Against Telmex, Again*, January 15, 2003.
[133] Jim Landers, "Making a tough call on Telmex – US ready to take Mexico's phone giant before WTO again", *The Dallas Morning News*, 18 February 2002.
[134] *Ibid.*

FCC benchmark rate of 19 cents per minute for international settlement rates but refused to make any significant reductions before January 2000 – the transition date set by the FCC when the benchmark rates will take effect for upper middle income countries with which Mexico has been classified.[135]

While the USTR was pressuring the Mexican government to address this situation, the telecoms operators themselves were in negotiations. In May 2001, Avantel's parent company, MCI WorldCom, and Telmex agreed to a settlement rate of 15.5 cents per minute rate from the US to Mexico for 2001, retroactive to 1 January 2001. The rate would go down further in 2002 to 13.5 cents per minute and down again to 10 cents per minute in 2003.

AT&T, unlike MCI WorldCom, did not agree to the rates. AT&T claimed that the new rates were still too high, far exceeding the cost of less than 4 cents per minute for completion of a call from US to Mexico. On 20 June 2001, AT&T, along with Concert, an international joint venture with British Telecom, filed a complaint with the FCC contending that the agreement between WorldCom and Telmex did not meet Mexico's WTO commitments. Moreover, AT&T criticized Telmex's style of negotiating only with the US carrier which it believes it may obtain the most advantageous agreement and then pressuring other US carriers to accept the same agreement. Eventually, both US telecoms companies came to an agreement with Telmex for the settlement rate of 14 cents per minute which, according to AT&T, was still well above the cost of interconnection. Despite the agreement reached by the private parties, the US nonetheless

[135] See Chapter 2, Section VI.5 on the ISR Order 1997.

brought a case against Mexico before the WTO dispute settlement system.[136]

Trade figures between the US and Mexico explain the US's action. Mexico is the second largest trading partner of the US after Canada, having overtaken Japan in 1999.[137] Two-way trade between the US and Mexico grew from $81.5 billion in 1993 to $232.2 billion in 2002. US exports of private commercial services to Mexico were $14.6 billion in 2001 and US imports were $11.0 billion. Sales of services in Mexico by majority-owned US affiliates were $6.7 billion in 2000, while sales of services in the US by majority-Mexico owned firms were $500 million. US foreign direct investment in Mexico in 2001 was $52.2 billion up from $32.9 billion in 2000.[138]

In terms of telecommunications trade figures, virtually all of Mexico's international telephone and fax traffic is with the US.[139] So heavy is this traffic that it constitutes the second largest international route for the US.[140] The amount of traffic originating in the US is about three times greater than the traffic originating in Mexico. The high rates coupled with trice the traffic originating in the US resulted in the US paying over $ 1 billion to Mexico in 2000 for the termination of calls.[141] These trade figures demonstrate the sheer size and significance of trade between the US and Mexico, including trade in telecommunications services which are traded in themselves and also provide the underlying transport means for other economic activities.

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136 The Mexican government was outraged by the US persistence to take it to the WTO's DSB, claiming that this action by the US was "dark". Reuters, "Mexico slams US over WTO telecoms complaint", 18 April 2002.
137 USTR, 2003 Trade Barrier Report, p. 271.
138 *Ibid.*
139 Cowey and Klimenko (2001), p. 41.
140 *Ibid.*
141 *US First Written Submission*, p. 1.

4. *The Mexico – Telecommunications Case: Legal Issues and Panel Decision*

The *Mexico – Telecommunications* case began when the US filed a request in the WTO for consultations with Mexico on 17 August 2000, a month after Vicente Fox became Mexico's President.[142] After two consultations and one failed attempt by the US to request the establishment of a panel, a panel was established at the Dispute Settlement Body (DSB) meeting on 17 April 2002.[143] The Panel issued a report on its decision of the case on 2 April 2004, and the DSB adopted it on 1 June 2004.[144]

(a) Summary of the Case

In *Mexico-Telecommunications*, the US alleged that Mexico violated its commitments in the GATS Annex on Telecommunications and its Reference Paper through Mexico's "International Long-Distance Rules" (ILD Rules)[145] and other actions.[146] The US complaint stated specifically: 1) Mexico's measures fail to ensure that Telmex provides interconnection to US cross-border basic telecommunications suppliers on reasonable rates, terms and conditions (required by Mexico's Reference Paper Sections

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[142] WTO, *Mexico – Measures Affecting Telecommunications Services*, Request for Consultations by the United States, WT/DS204/1, S/L/88, 29 August 2000.
[143] WTO, *Mexico-Telecommunications*, Constitution of the Panel Established at the Request of the United States, WT/DS204/4, 30 August 2002.
[144] WTO, *Mexico – Measures Affecting Telecommunications Services*, Panel Report, WT/DS204/R, adopted 1 June 2004 (*Mexico-Telecommunications*); WT/DS204/8, 9 June 2004.
[145] Reglas para prestar el Servicio de Larga Distancia Internacional que deberán aplicar los concesionarios de redes publicas de telecomunicaciones autorizados para prestar este servicio, 11 December 1996. Hereinafter the "International Long-Distance Rules" (ILD Rules). Available at http://www.cft.gob.mx/html/9_publica/reglas/11dic96.html.
[146] WTO, *Mexico – Measures Affecting Telecommunications Services*, Request for the Establishment of a Panel by the United States, WT/DS204/3, 18 February 2002.

2.1 and 2.2 obligations); 2) Mexico's measures do not prevent Telmex from engaging in anti-competitive practices (Section 1 of the Reference Paper); and 3) Mexico's measures fail to ensure US basic telecommunications supplier reasonable and non-discriminatory access to and use of public telecommunications networks and services (Section 5 of GATS Annex on Telecommunications).[147]

The government measures at issue in the case were: 1) the Federal Telecommunications Law (FTL),[148] 2) the ILD Rules,[149] 3) the Rules for Long-Distance Service,[150] and 4) the SCT Agreement.[151]

(b) Issues of interpretation

Mexico-Telecommunications is the first WTO case involving trade in telecommunications services as well as the first WTO case purely on trade in services. The Panel was called upon to provide interpretations into the terms used in the Reference Paper, the GATS and the Annex on Telecommunications Services as well as clarifying the way services commitments should be scheduled. The Panel, however, held that the legal findings were limited to this particular case so that their interpretations on telecommunications services do not apply to other service sectors:

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[147] *Ibid.* The US request also contained a fourth complaint, that Mexico's measures did not provide national treatment to US-owned commercial agencies (GATS Article XVII). This point was however later dropped in the US's First Written Submission to the Panel (3 October 2002, WT/DS204).
[148] *Supra* n. 126.
[149] *Supra* n. 145.
[150] *Reglas del Servicio de Larga Distancia* published by the SCT on 21 June 1996.
[151] The "Agreement of the SCT establishing the procedure to obtain concessions for the installation, operation or exploitation of interstate public telecommunications networks, pursuant to the Federal Telecommunications Law" (*Acuerdo de la SCT por el que se establece el procedimiento para obtener concesión para la instalación, operación o explotación de redes públicas de telecomunicaciones interestatales, al amparo de la Ley Federal de Telecomunicaciones*) published on 4 September 1995.

> The limited legal task of dispute settlement findings [...] is to decide on the legal claims, in a particular dispute, based on the "ordinary meaning" of the WTO provisions concerned "in their context" and in light of the "object and purpose" of the agreement. Our legal findings are thus limited to the dispute meaning and scope of certain GATS obligations and commitments of Mexico in the very particular context of this bilateral dispute, and do not go beyond what we consider indispensable for deciding on the legal claims submitted to the Panel. Our focus on telecommunications services may mean that certain elements of our findings in this particular services sector may not be relevant for other services sectors with different legal, economic and technical contexts.[152]

In its interpretation of the issues and Mexico's commitments in the case, the Panel applied the general rules of interpretation set out in the Vienna Convention on the Law of Treaties 1969.[153] Article 3.2 of the Dispute Settlement Understanding (DSU) provides that panels are to clarify the provisions of the WTO agreements in accordance with customary rules of interpretation of public international law. In the WTO case *US – Gasoline*, the Appellate Body established that the fundamental rules of treaty interpretation as set out in Articles 31 and 32 of the Vienna Convention on the Law of Treaties 1969 had "attained the legal status of a rule of customary international or general international law" and "forms part of the 'customary rules of interpretation of public international law'".[154] The Panel stated that since the commitments provided for in Mexico's Schedule are part of the terms of the treaty (GATS), the general rules of interpretation set out in the VCLT apply.[155]

Some of the terms whose interpretation is at issue in the case include:

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152 *Mexico-Telecommunications*, para. 7.3
153 Hereinafter the VCLT.
154 WTO, Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, p. 17.
155 *Mexico-Telecommunications*, para. 7.15. GATS Article XX:3.

- "none" or "unbound" when scheduling commitments for market access;[156]
- "facilities" as being broader than just "international ports" and perhaps embracing a variety of means that might be used to terminate cross-border traffic, including private leased circuits;
- "interconnection" in the context of Section 2 of the Reference Paper and whether it includes international interconnection and thus the international accounting rate regime;
- "reasonable" in the context of interconnection agreements in Section 2 of the Reference Paper whether 'reasonable' should be interpreted according to its ordinary English meaning ("in accordance with reason; not irrational or absurd; within the limits of reason"), so that terms and conditions of an interconnection agreement are reasonable if they are appropriate or sensible or rational;[157]
- "cost-based" when determining interconnection rates; and
- "anti-competitive practices" in terms of Section 1 of the Reference Paper.[158]

[156] The WTO Panel had to decide on the way commitments are scheduled for services – which is not straight forward like for that of goods. The panel had to clarify that scheduling "none" means that there are no limitations to market access and that the market of the scheduled sector is fully open. The panel also had to resolve the argument, asserted by Mexico, that a limitation scheduled under one mode of supply can be "read together" or "in combination" with another limitation listed under a different mode – the US claimed that this line of argument is without any legal support.

[157] *US Second Written Submission*, para. 73.

[158] The Reference Paper does not define "anti-competitive practices" but there is a non-exhaustive list of what constitutes anti-competitive practices. The US contended that anti-competitive practices includes, at the very least, horizontal price-fixing agreements. *US Second Written Submission*, para. 80.

(c) Issues of scheduled commitments: the services at issue

Before determining whether a Member has violated its GATS commitments in a particular case, the Panel must first establish what commitments the Member has made. Where specific commitment obligations are concerned, the Member's individual schedule must be consulted. In *Mexico-Telecommunications*, the Panel had to determine whether Mexico had made commitments for the supply of basic telecommunications services through modes 1 and 3.

We recall from Chapter 3 that the cross-border supply of services (mode 1) is, in most cases, straightforward because it does not involve the movement of either supplier or consumer to travel to one another in order for trade to take place. However, in *Mexico-Telecommunications* this mode of delivery has proved to be a subject of contentious arguments between Mexico and the US:

> The United States' claims regarding the services at issue relate to the GATS mode of supply known as cross-border supply of these services. However, the parties do not agree that the services at issue are actually being supplied by this mode of supply.[159]

The Panel's first task was thus to determine whether the telecommunications services at issue in the case are in fact supplied cross-border.

Mexico argued that the services at issue could not be interpreted to be supplied cross-border because an operator who simply "hands off" telecommunications traffic at the border to another operator would not be supplying cross-border within the meaning of GATS Article I:2(a) because

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159 *Mexico-Telecommunications*, para. 7.24.

this "handing-off" amounts to a "half-circuit" provision of the telecommunications services – only "full-circuit" or "end-to-end" provision by the *same* operator constitutes cross-border supply.[160]

The Panel rejected Mexico's arguments after citing definitions of basic telecommunications services from the Annex on Telecommunications and the description of "public long distance voice telephone services" in the CPC[161] and came to the conclusion that basic telecommunications services are services supplied "between two or more points", whereby the undertaking of the transmission between the points does not have to be done by a single supplier, and that long-distance telephone service consists of giving a customer access to both "the supplier's and connecting operator's entire telephone network".[162]

Thus, the Panel concluded that the definition of basic telecommunications services does not imply or require "end-to-end" service by one and the same operator but in fact anticipated the "interworking of both operating networks in order for the service to be performed."[163] Furthermore, the Panel stated:

> It would be unreasonable to assume that the definition of telecommunications services applies only where a telecommunications supplier itself owns or controls a complete global infrastructure allowing it to reach every potential "point" requested by its customer. Had WTO Members intended this to be the case, they surely would have made it explicit in the definition.[164]

The Panel thus found that the services at issue in *Mexico-Telecommunications*, in which US telecommunications suppliers link their networks at the border with those of Mexican suppliers for termination of

[160] *Mexico-Telecommunications*, para. 7.27.
[161] The CPC is the abbreviation for the UN Provisional Central Product Classification. UN, Statistical Papers, Series M No. 77, Provisional Central Product Classification, 1991.
[162] *Mexico-Telecommunications*, paras. 7.30-7.36
[163] *Mexico-Telecommunications*, para. 7.36.
[164] *Mexico-Telecommunications*, para. 7.34.

the service in Mexico, without US suppliers operating, or being present in any way, in Mexico, are services which are supplied cross-border within the meaning of GATS Article I:2(a).[165]

The Panel then had to establish whether Mexico had undertaken commitments on the cross-border supply of basic telecommunications services at issue in the case. This required examining Mexico's Schedule of specific commitments (see Appendix X).[166] In the first column of Mexico's Schedule (the services sector column), Mexico has inscribed the following:

> Telecommunications services supplied by a *facilities-based* public telecommunications network (wire-based and radio-electric) through any existing technological medium, included in subparagraphs (a), (b), (c), (f), (g) and (o).[167] (emphasis added)

The Panel interpreted the term "facilities-based" in this introductory heading in Mexico's sector column, according to its ordinary meaning. The Panel determined that the term suggests "infrastructure, or the physical elements by means of which the service is supplied"[168] and that therefore "on its face suggest that the telecommunications services committed in Mexico's Schedule must be supplied [...] by an operator over its *own* infrastructure, and not over infrastructure leased from another operator."[169]

The Panel consulted supplementary documents to confirm the meaning of "facilities-based", in particular three important documents

[165] *Mexico-Telecommunications*, para. 7.45.
[166] See also Chapter 3, Section IV.2.
[167] The subparagraphs include voice telephony, packet-switched data transmission services, circuit-switched data transmission services, facsimile services, private leased circuit services, and other (including commercial agencies), respectively. See Appendix X.
[168] *Mexico-Telecommunications*, para. 7.55
[169] *Mexico-Telecommunications*, paras. 7.55-7.56.

used by Members as guidance in drawing up their schedules, namely: the Draft Model Schedule,[170] the related Note by the Chairman of the GBT,[171] and the Scheduling Guidelines.[172] From analyzing the supplementary documents, the Panel established that,

> The word "facilities-based" [...] contained in the introductory heading to Mexico's telecommunications commitments means that Mexico has undertaken commitments for the services at issue supplied *only on a facilities basis over such networks* – and not by resale or leased capacity.[173]

Having established the telecommunications services listed in Mexico's sector column, the Panel determined what cross-border commitments Mexico has undertaken with respect to these services. In the market access column under mode 1, Mexico has inscribed "none" except international traffic must be routed through the facilities of an enterprise that has a concession from the SCT. The Panel, disagreeing with the US,[174] found that, due to the committed services in Mexico's sector column, this "routing requirement" on market access for mode 1 is a limitation within the categories of GATS Article XVI:2(a), (b) and (c) for the supply of telecoms services through *leased-lines* capacity in Mexico.[175] However, the Panel held that,

> while this limitation prohibits services that originate on a facilities basis from being terminated over leased circuits, it does not prevent these services from being supplied when they fall within the facilities-based category with respect to termination."[176]

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[170] See WTO, NGBT, *Negotiations on Basic Telecommunications*, Note by the Secretariat, TS/NGBT/W/1, 2 May 1994.
[171] WTO, GBT, *Notes for Scheduling Basic Telecommunications Services Commitments*, Note by the Chairman, Revision, S/GBT/W/2/Rev.1, 16 January 1997.
[172] WTO, *Guidelines for the Scheduling of Specific Commitments under the GATS*, adopted 23 March 2001, S/L/92; and GATT, *Scheduling Initial Commitments in Trade in Services: Explanatory Note*, MTN.GNS/W/164, 3 September 1993.
[173] *Mexico-Telecommunications*, para. 7.71.
[174] See *Mexico-Telecommunications*, paras. 4.109, 4.113, 7.46.
[175] *Mexico-Telecommunications*, para. 7.85.
[176] *Mexico-Telecommunications*, para. 7.85.

The Panel found overall that,

> the inscription in Mexico's Schedule of the routing requirement prohibits market access for the supply of the services at issue on a non-facilities basis (over capacity leased by an operator) in Mexico, but allows full access for the services at issue supplied on a facilities-basis (*not* over capacity leased by an operator) in Mexico – subject to routing the traffic through Mexican enterprises that have a "concession".[177]

Having established Mexico's telecoms services commitments as inscribed in its Schedule, the Panel then proceeded to determine whether Mexico has fulfilled its commitments under Sections 2.1 and 2.2 of the Reference Paper with regard to the cross-border supply of the basic telecommunications at issue.

(d) Issues of interconnection and accounting rates: Section 2 of the Reference Paper

There is a two-step process to determining whether Mexico has fulfilled its commitments under Sections 2.1 and 2.2 of the Reference Paper. First, the Panel had to determine whether Mexico has undertaken commitments under Section 2 of the Reference Paper in the first place. If the answer was yes, the Panel then had to decide whether Mexico had fulfilled those commitments.

The most important part of the US case against Mexico revolved around the issue of interconnection rates. The focus of the argument was whether interconnection rate in Section 2 of the Reference Paper is synonymous with international accounting rate – the traditional form of settling costs for the termination of international calls between carriers of

[177] *Mexico-Telecommunications*, para. 7.91; and see paras. 7.77- 7.91.

one country and those of another.[178] The Reference Paper does not contain any reference to the term "accounting rate", but the section on interconnection rates requires that interconnection rates are reasonable and based on costs.

The US argument was that interconnection rates and termination rates and accounting rates are different terms about the same things – the price privately negotiated by telecommunications carriers to terminate one another's calls. The US claimed that the rate US carriers had to pay Mexican carriers was not reasonable and not cost-based but was in fact well above costs. This, the US claimed, was a violation of Mexico of its WTO commitments.

Mexico's response was that it did not undertake a specific commitment in its Schedule to permit the supply of cross-border supply of basic telecommunications services. In any case, the obligations of the Reference Paper extended only to "*domestic* interconnection". According to Mexico, "international interconnection" or "accounting rate regimes" is not "interconnection" as defined in Mexico's Reference Paper.[179] Mexico also argued that the US had failed to show that Mexico's interconnection rates were not "*basadas en costos*" (cost-oriented) or that the terms and conditions of interconnection were unreasonable.

The Mexican telecommunications law at the centre of the US case is contained in the ILD Rules, more specifically the rules on the "uniform settlement rate" system, which the US argued prohibit competition.[180] ILD Rule 13 allows the long-distance operator with the highest volume of outgoing traffic on a particular international route, which has always been

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[178] See also Chapter 2, Section VI.5.
[179] Oral Statement of the US at the First Panel Meeting, 17 December 2002, para. 19.
[180] ILD Rules 10 and 13.

Telmex, to have the exclusive right to establish the terms and conditions for the termination of all international calls. What this means is that Telmex alone can negotiate the terms and conditions, including the settlement rates and termination rates, with a foreign carrier in another country, for instance the US, and under ILD Rule 10, other Mexican carriers providing international services must adopt these terms and conditions agreed by Telmex with the foreign carriers.

The interpretation of "interconnection rate" was important to both the US and Mexican cases and to international telecommunications generally.

1) The meaning of "interconnection"

The Panel needed to determine the meaning of "interconnection" as found in the Reference Paper in order to establish whether Mexico had undertaken commitments under Section 2 of the Reference Paper. The Panel applied the rules of treaty interpretation as set out in Articles 31 and 32 of the VCLT as follows. First, the Panel determined the ordinary meaning of "interconnection", thus applying the first element of Article 31(1) of the VCLT. Second, the Panel looked at the context provided by the term "interconnection", thereby applying Article 31(1) of the VCLT, second element – "in their context". Third, the Panel examined other contextual elements. Fourth, the Panel determined the object and purpose of the treaty (the GATS), applying the third element of Article 31(1) VCLT. Fifth, the Panel took into account "supplementary means" of interpretation – in this case the "Understanding on Accounting Rates" – applying Article 32 VCLT. Sixth, the Panel examined "other supplementary means" which may be relevant by looking at the drafting history of the Reference Paper.

a) "Ordinary meaning"

In determining the ordinary meaning of "interconnection", the Panel found as follows: 1) Section 2 of the Reference Paper could not be read to exclude suppliers outside Mexico from "linking" to public telecommunications transport networks and services in Mexico;[181] 2) the term "interconnection" is used in Mexico for interconnection between domestic networks, and between domestic and foreign networks;[182] 3) from a commercial perspective, domestic and international interconnection do not differ significantly thus disagreeing with Mexico's argument that international interconnection under a traditional, "joint service" regime is distinctive because the two operators cooperate, and do not compete for the same customers as they do in domestic interconnection;[183] 4) from a contractual perspective, there are no significant differences between the domestic and international interconnection arrangements, including through accounting rate regimes;[184] and 5) from a technical perspective, the "mid-point" cross-border link-up, which Mexico argued is particular to international interconnection, arises also in certain situations of domestic interconnection.[185]

Having found the above, the Panel concluded that "interconnection" in Section 2 of the Reference applies to both domestic and international interconnection, including, significantly, the accounting rate regimes. This is,

[181] *Mexico-Telecommunications*, para. 7.105.
[182] *Mexico-Telecommunications*, para. 7.110.
[183] *Mexico-Telecommunications*, para. 7.113.
[184] *Mexico-Telecommunications*, para. 7.114.
[185] *Mexico-Telecommunications*, para. 7.116.

confirmed by an examination of any "special meaning" that the term "interconnection" may have in telecommunications legislation, or by taking into account potential commercial, contractual or technical differences inherent in international interconnection. We find that any "special meaning" of the term "interconnection" in Section 2 of Mexico's Reference Paper does not justify a restricted interpretation of interconnection, or of the term "linking", which would exclude international interconnection, including accounting rate regimes, from the scope of Section 2 of the Reference Paper.[186]

b) "Object and purpose" of the treaty

The Panel turned to the "object and purpose" of the treaty – the GATS – to find further support for the interpretation of "interconnection" derived from the examination of the ordinary meaning of the term in its context, and in so doing applied the third element of Article 31(1) of the Vienna Convention. In its reasoning, the Panel stated:

Article I:1 of the GATS provides that the agreement extends to "measures affecting trade in services". Trade in services is defined in Article I:2 to include the cross-border supply of a service "from the territory of one Member into the territory of any other Member" [...] Since the GATS deals specifically with international trade in services by four modes of supply that are considered comprehensive, it would indeed be unusual for interconnection disciplines not to extend to an obvious and important mode of international supply of telecommunications services – cross border.[187]

c) Supplementary means

The Panel, applying Article 31(2) VCLT, undertook further to examine "supplementary means" to find additional support for the interpretation of interconnection. The Panel examined the "Understanding on Accounting Rates" and the drafting history of the Reference Paper to "confirm the meaning" resulting from the application of the primary means of interpretation.[188] Mexico had based extensive arguments on these

[186] *Mexico-Telecommunications*, para. 7.117.
[187] *Mexico-Telecommunications*, para. 7.121.
[188] *Mexico-Telecommunications*, para. 7.122.

supplementary means to support its case that the reading of the term "interconnection" to include interconnection with foreign suppliers and networks would lead to a result which is "manifestly absurd and unreasonable".[189]

The Panel first set out to state that the "Understanding" cannot directly affect the scope of Mexico's obligations under Section 2 of the Reference Paper because the Understanding was non-binding and contains no substantive obligations.[190] The Panel concluded that, "any interpretive value of the Understanding lies only in the *guidance* it might give in determining the scope of the interconnection provision in Section 2 of Mexico's Reference Paper."[191]

The "Understanding" is contained in a Report of the Group on Basic Telecommunications adopted at the end of the extended negotiations on basic telecoms on 15 February 1997.[192] It is not a binding agreement, but a "gentleman's agreement" with respect to the application of differential accounting rates to telecommunications services and service suppliers of other Members, as set out in paragraph 7.[193] The "Understanding" states:

> In light of the fact that the accounting rate system established under the International Telecommunications Regulations is the usual method of terminating international traffic and by its nature involves differential rates, and in order to avoid the submission of further such [MFN] exemptions, it is the understanding of the Group that:
> - the application of such accounting rates would not give rise to action by Members under dispute settlement under the WTO; and
> - that this understanding will be reviewed not later than the commencement of the further Round of negotiations on Services Commitments due to begin not later than 1 January 2000.[194]

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[189] *Mexico-Telecommunications*, para. 7.123.
[190] *Mexico-Telecommunications*, para. 7.126.
[191] *Ibid.* Emphasis added.
[192] WTO, GBT, *Report of the Group on Basic Telecommunications*, S/GBT/4, 15 February 1997.
[193] *Ibid.*
[194] *Ibid.*

Thus, the "Understanding" is not to bring dispute cases to the WTO with regard to *differential* rates of accounting, which would otherwise be in conflict with the GATS MFN obligation of Article II.

The Panel stated that,

> The main interpretative issue arising from the Understanding is whether the non-binding decision to exclude from the scope of the WTO dispute settlement "differential" accounting rates "established under the International Telecommunications Regulations" for the purposes of the MFN obligation, implies also an intent to exclude from the substantive scope of the Reference Paper international interconnection – in particular, the international linking of the networks of Mexican and United States suppliers.[195]

In order to determine the scope of the "Understanding", in other words the accounting rate system established under the International Telecommunications Regulations, the Panel examined the International Telecommunications Regulations, its Appendix,[196] and relevant non-binding Recommendations on the international accounting rate system made by a special ITU study group (ITU-T Study Group 3).[197] The Panel came to the following conclusion:

> Read together, the Regulations, its Appendix, and the related Recommendations result today in a number of different ways in which operators in different countries can be compensated for international traffic exchanged between them, ranging from traditional methods to more modern alternatives. Regardless of whether the traditional or new alternative arrangements are being used, the ITU instruments require that the arrangements be cost-oriented and non-discriminatory.
>
> We therefore conclude that the accounting rates described in the Understanding should be understood to be limited to: (a) a traditional accounting rate that is not cost-oriented; (b) that can be interpreted as a measure of a Member, or that triggers a Member's obligations under Article VIII on monopolies; and (c) that applies discriminatory rates on the basis of the national origin of the cross-border traffic, and thus may be inconsistent with the MFN principle in Article II.[198]

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[195] *Mexico-Telecommunications*, para. 7.128.
[196] *International Telecommunications Regulations (ITR)*, forming part of the Final Acts of the World Administrative Telegraph and Telephone Conference, Melbourne, 1988 (WATTC-88); ITR Appendix 1.
[197] ITU-T Recommendation D.140, *Accounting Rate Principles for International Telephone Service*, July 1998; ITU-T Recommendation D.150, *New System for Accounting in International Telephony*, June 1999.
[198] *Mexico-Telecommunications*, paras. 7.135 and 7.136.

From this analysis of accounting rates, the Panel went on to state that:

> First, not *all* international interconnection pricing was excluded from dispute settlement by the Understanding, only traditional accounting rate regimes with "differential rates". Second, the exclusion was from dispute settlement, not from the substantive obligations of the GATS, including its schedules of commitments. Third, the explicit aim of the exclusion was the MFN obligation under GATS Article II. Other obligations or specific commitments in the GATS, such as Section 2 of Mexico's Reference Paper were not specified. Fourth, not all traditional accounting rate regimes would be MFN inconsistent, even if they were *not* cost-oriented [...] Finally, the existence of the Understanding demonstrates that, even though negotiators considered at length the issue of rates for international interconnection, they chose not to adopt wording that would have expressly excluded certain types of interconnection from the scope of the Reference Paper.[199]

And from this, the Panel came to the conclusion that,

> In sum, the Understanding seeks to exempt a very limited category of measures, temporarily, and on a non-binding basis, from the scope of WTO dispute settlement. Simply because Members wished to shield a *certain type* of cross-border interconnection from dispute settlement, because of *possible* MFN inconsistencies (with respect to differential rates), it does not follow that they wished to shield *all* forms of cross-border interconnection from dispute settlement. The clear intention to do so is not expressed in the Understanding. This suggests that the content and purpose of the Understanding is of limited assistance in interpreting the scope of application of the term "interconnection" in Section 2.1 of Mexico's Reference Paper.[200]

Thus, the Understanding on Accounting Rates did not help Mexico's cause, and the conclusion on the interpretation of "interconnection" so as to include interconnection of international telecoms services is not affected by the Understanding.

The Panel thus held that Section 2 of Mexico's Reference Paper applies to the interconnection of cross-border suppliers. Furthermore, the Panel had earlier determined that Mexico has undertaken market access and national treatment commitments in is Schedule with respect to the cross-border supply of the facilities-based services at issue; and these commitments can provide the basis for interconnection commitments in

199 *Mexico-Telecommunications*, para. 7. 137.
200 *Mexico-Telecommunications*, para. 7.138.

Section 2.2(b) of Mexico's Reference Paper.[201] The Panel therefore found overall that Section 2.2(b) of Mexico's Reference Paper applies to US service suppliers supplying or seeking to supply the services at issue.[202]

The Panel next determined whether Mexico has fulfilled its commitment in Section 2.2(b) of its Reference Paper.

2) Has Mexico fulfilled its Reference Paper Section 2.2(b) commitment?

Section 2.2(b) of Mexico's Reference Paper states:

> Interconnection with a major supplier will be ensured at any technically feasible point in the network. Such interconnection is provided:
> (b) in a timely fashion, on terms, conditions (including technical standards and specifications) and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require for the service to be provided.

The Panel thus determined the relevant elements of Section 2 of Mexico's Reference Paper in order to find whether Mexico has fulfilled its commitments.

a) Is Telmex a major supplier?

To determine whether an operator is a major supplier involves a three-step process.

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[201] *Mexico-Telecommunications*, paras. 7.91 and 7.95; see also Section III.4(c) above.
[202] Mexico-Telecommunications, para. 7.144.

i) What is the "relevant market" for the telecoms services at issue in the case?

The Panel decided, agreeing with the US, that the relevant market in this particular case is the market for the termination of the services at issue in Mexico (i.e. cross-border basic telecoms services from US to Mexico).[203] The Panel reasoned as follows:

> [T]he notion of demand substitution – [...] whether a consumer would consider two products as "substitutable" – is central to the process of market definition as it is used by competition authorities. Applying that principle, we find no evidence that a domestic telecommunications service is substitutable for an international one, and that an outgoing call is considered substitutable for an incoming one. One is not a practical alternative to the other. Even if the price difference between domestic and international interconnection would change, such a price change would not make these different services substitutable in the eyes of a consumer.[204]

Sidak and Singer, however, remark that this determination by the Panel was incorrect on economic grounds, being inaccurately narrow in scope.[205] They argue that the relevant market is point-to-point long-distance international service between the US and Mexico, and the key to the proper market definition in this case is to recognize that a southbound call is a substitute for a northbound call.[206] Thus, according to Sidak and Singer, the Panel, by identifying incorrectly the relevant market, determined erroneously that Telmex is a major supplier because in the point-to-point market Telmex does not have market power.[207] In any case they argue that even if the relevant market were termination of services

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203 *Mexico-Telecommunications*, para. 7.152
204 *Ibid.*
205 J. Gregory Sidak and Hal J. Singer, "Uberregulation without Economics, The World Trade Organization's Decision in the US-Mexico Arbitration on Telecommunications Services", (Draft) (August 2004), p. 24.
206 *Ibid.*
207 *Ibid.*, pp. 27-34

Telmex does not have market power even in that market and is thus not a major supplier.[208]

ii) Does Telmex have "the ability to materially affect the terms of participation (having regard to price and supply) in that market? If yes,

iii) Does the ability result form "control over essential facilities" or "use of its position in the market"?

With regard to the second criterion, the Panel had no difficulty in determining that Telmex has "the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market" by way of the Mexican ILD Rules which accord Telmex special powers. ILD Rule 13 in particular grants to the long-distance licensee with the highest volume of outgoing traffic on a particular international market the sole right to negotiate settlement rates which, under Rule 10, all other operators must apply. And since Telmex has always had the largest share of outgoing traffic in every international market, including the US, it is, and has consistently been under the Rules, the "licensee authorized to negotiate settlement rates". The Panel thus found,

In these circumstances, since Telmex is *legally* required to negotiate settlement rates for the entire market for termination of the services at issue from the United States, we find that it has patently met the definitional requirement in Mexico's Reference Paper that it [has] the "ability to materially affect the terms of participation", particularly "having regard to price".[209]

The Panel further found that Telmex's ability to impose its negotiated settlement rate for an international route on its competitors, which is

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[208] *Ibid.*, p. 34.
[209] *Mexico-Telecommunications*, para. 7.155.

granted to it under the ILD Rules, is the use of Telmex of its special "position in the market". Thus, the Panel's findings in each of the three criteria led them to conclude that Telmex is a major supplier with respect to termination of the services at issue in the case.[210]

b) Are Telmex interconnection rates cost-oriented?

i) "having regard to economic feasibility"

This phrase qualifies the term "cost-oriented" rates, and confirms that interconnection rates should cover "both direct costs and should permit a reasonable rate of return on the investor's investment".[211]

ii) LRAIC method to determine cost-oriented rates

The Panel determined that the ordinary meaning of "cost-oriented" rates means that rates,

> are *brought into a defined relation to known costs or cost principles.* Rates that are "cost-oriented" would not need to equate exactly to cost, but should be founded on cost. The degree of flexibility inherent in the term "cost-oriented" suggests, moreover, that more than one *costing methodology* could be used to calculate "cost-oriented" rates.[212]

The Panel also went further and looked at the "special meaning" of "cost-oriented" since it is a technical term that may have such a meaning in the telecoms sector. Having resorted to ITU studies, in particular

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[210] *Mexico-Telecommunications*, para. 7.159.
[211] See *US Second Written Submission*, para. 68 and *Mexico-Telecommunications*, para. 7.161.
[212] *Mexico-Telecommunications*, para. 7.168.

Recommendations D.140 and D.150 which deal with accounting rates for international telephone services, the Panel concluded that the special meaning of "cost-oriented", in the context of the ITU which require that the cost elements and the cost model both be clearly related to the cost of delivering the service, is consistent with the ordinary meaning of the term as it appears in Mexico's Reference Paper.[213]

The Panel thus accepted the US argument that the ordinary meaning of cost-oriented is relevant to the costs incurred in supplying the service.[214] This meaning is amplified by the use of this term in many WTO Members' telecommunications laws and regulations (e.g. the EC and even Mexico). Mexican law, in particular, requires the use of long-run average incremental cost (LRAIC) principles, which are consistent with interconnection rates that relate to the cost of providing that service. The Panel thereby found that,

> the increasing and wide-spread use of incremental cost methodologies among WTO Members supports the interpretation of the term "cost-oriented" as meaning the costs incurred in supplying the service, and that the use of long term incremental cost methodologies, such as those required in Mexican law, is consistent with this meaning.[215]

In determining the qualifying terms of "reasonable" and "having regard to economic feasibility", the Panel first considered the term "reasonable" and concluded that this term suggests that the interconnection rates should be "suitable to the circumstances or purpose", in other words, "reflect the overall objectives of the provision that the rates represent the costs incurred in providing the service".[216] The word "reasonable" thus emphasizes that the application of the cost

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[213] *Mexico-Telecommunications,* para. 7.174.
[214] *Mexico-Telecommunications,* paras. 7.177 and 7.160.
[215] *Mexico-Telecommunications,* para. 7.177.
[216] *Mexico-Telecommunications,* para. 7.182.

model chosen by the Member reflects the cost incurred for the interconnection service.[217] The Panel reasoned therefore that the word "reasonable" would not permit costs that were not incurred in the supply of the interconnection service to be included in the rate. Thus, the Panel rejected Mexico's suggestion that the general state of the telecoms industry, the coverage and quality of the network, and whether rates were established under the accounting rate regime needed to be considered when determining cost-oriented rate. These criteria, the Panel ruled, are not relevant to determining cost-oriented rate.[218]

As to the phrase "having regard to economic feasibility", the Panel accepted the US and EC interpretations that this means the major supplier is entitled to rates that allow it to undertake interconnection on an "economic" basis, that is, to make a reasonable rate of return, and does not take into account a country's policy goals, such as universal service, or the needs of the operator, as Mexico argued.[219]

Having determined the meaning of cost-oriented rates, the Panel had to determine whether Telmex interconnects US suppliers at these rates. As Mexico did not offer its comments on the specific methods of evaluating costs and settlement charges presented by the US, nor submitted its own calculations, the Panel based its decision on the US methodology and found that it provides a useful indication of the costs incurred by Telmex in interconnecting US suppliers and terminating calls in Mexico.[220] The Panel accepted in principle the US method for determining the difference between interconnection rates charged by Telmex to US suppliers of the

[217] *Ibid.*
[218] *Mexico-Telecommunications*, para. 7.183.
[219] *Mexico-Telecommunications*, para. 7.184, and see Mexico's second written submission paras. 87-97.
[220] *Mexico-Telecommunications*, paras. 7.188 and 7.191.

services at issue, and the aggregate costs for relevant network components.[221]

The Panel found that it is a justified presumption that any substantial difference between the two figures was evidence that Telmex's interconnection rates were not "cost-oriented" in the context of Section 2.2(b) of Mexico's Reference Paper.[222] On the evidence that the blended average difference in costs and rates charged by Telmex is around 77% (based on US calculations, and uncontested by Mexico),[223] the Panel found that,

> [T]he interconnection rates charged by Telmex to United States suppliers of the services at issue are not "cost-oriented" within the meaning of Section 2.2(b) of Mexico's Reference Paper, since by any of the methodologies presented to the Panel by the United States, they are substantially higher than the costs which are actually incurred in providing the interconnection.[224]

The Panel therefore found that Mexico has failed to fulfil its commitments under Section 2.2(b) of its Reference Paper by failing to ensure that a major supplier in terms of Section 2.2 of the Reference Paper (Telmex) provides interconnection to US basic telecoms suppliers of the services at issue on a facilities basis under cost-oriented rates.[225]

(e) Issues of anti-competitive behaviour: Section 1 of the Reference Paper

The US's second allegation against Mexico was that Mexico's ILD Rules violate Section 1 of the Reference Paper because instead of preventing

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[221] The Panel accepted the evidence presented by the US, and uncontested by Mexico, that the relevant network components of Telmex used to interconnect US cross-border suppliers include: international transmission and switching, local links, subscriber line, and long-distance links. *Mexico-Telecommunications*, para. 7.196.
[222] *Mexico-Telecommunications*, para. 7.203.
[223] *Mexico-Telecommunications*, paras. 7.202-7.203.
[224] *Mexico-Telecommunications*, para. 7.216.
[225] *Mexico-Telecommunications*, para. 7.216.

anti-competitive practices, the Rules actually *promote* anti-competitive behaviour. To determine this, the Panel had to consider the following questions: 1) Is Telmex a "major supplier"? 2) What are "anti-competitive practices"? 3) Do the ILD Rules require a major supplier to engage in anti-competitive practices? 4) Has Mexico maintained "appropriate measures" to prevent anti-competitive practices by a major supplier?

The first question was answered by the Panel when they considered Section 2 of Mexico's Reference Paper – yes, Telmex is a major supplier.[226]

1) What are anti-competitive practices?

The Panel noted that "anti-competitive practices" is not defined in the Reference Paper. The Panel determined, consistent with its ordinary meaning, that "anti-competitive practices" is broad in scope and suggests actions that "lesson rivalry or competition in the market".[227] The Panel confirmed that the list of anti-competitive practices in Section 1 of the Reference Paper is non-exhaustive – and includes horizontal price-fixing and market-sharing agreements by suppliers.[228] The Panel determined that, from examining competition laws of WTO Members, practices that are unlawful under the competition laws of Members included cartels or collusive horizontal agreements between firms, such as agreements to fix prices or share markets, in addition to other practices such as abuse of a dominant position and vertical market restraints.[229]

The Panel held that practices endorsed/required by a Member's law, and not freely undertaken by a major supplier, can be anti-competitive

[226] See Section III.4(d)(2)(a) above.
[227] Mexico-Telecommunications, para. 7.230.
[228] *Mexico-Telecommunications*, paras. 7.232 and 7.237-8.
[229] Mexico-Telecommunications, para. 7.235.

within the meaning of the Reference Paper.[230] The Panel reasoned that Reference Paper commitments undertaken by a Member are international obligations owed to all other WTO Members and domestic laws cannot be used to undermine international commitments made: Article 27 of the VCLT established the principle that a requirement imposed by a Member under its internal law cannot unilaterally erode its international commitments.[231] Thus, Mexican law can be "anti-competitive" practices within the meaning of Section 1 of Mexico's Reference Paper.[232]

2) Do the ILD Rules require a major supplier to engage in anti-competitive practices?

Next, the Panel had to determine whether Mexico's ILD Rules do in fact require a major supplier to engage in anti-competitive practices. The Panel determined that the ILD Rules require Telmex and other Mexican operators to apply a uniform settlement rate (Rule 13) and to ensure a proportionate return of incoming calls, compared to outgoing calls (Rules 16 and 2:XIII).

In sum, the ILD Rules impose two main requirements on Telmex on the US-Mexico route. First, Telmex must negotiate a settlement rate for incoming calls with suppliers in other markets wishing to terminate calls in the Mexican market and apply, subject to approval by the Mexican authorities and in common with the other Mexican suppliers, that single

[230] *Mexico-Telecommunications*, para. 7.245.
[231] *Mexico-Telecommunications*, para. 7.244.
[232] *Mexico-Telecommunications*, para. 7.245. As the US correctly pointed out, "anti-competitive practices do not change their nature simply because they are required by national laws and regulations ... and the provision would be self-defeating and meaningless if a Member could easily avoid the obligation to maintain appropriate measures to prevent anti-competitive practices by formally requiring such practices". *Mexico-Telecommunications*, para. 7.240.

rate to interconnection for incoming traffic from the US ("uniform settlement rate system"). Second, Telmex must give up traffic to, or accept traffic from, other suppliers depending on whether the proportion of incoming traffic surpasses, or falls short of, its proportion of outgoing traffic ("proportionate return system"). To this end, Telmex may enter into "financial compensation agreements" with other operators, which are to be approved by Mexican authorities (ILD Rule 17).

The Panel agreed with the US argument that "the removal of price competition by the Mexican authorities, combined with the setting of the uniform price by the major supplier, has effects tantamount to those of a price-fixing cartel".[233] As the Panel had earlier determined that horizontal practices such as price-fixing among competitors are "anti-competitive practices" under Section 1 of Mexico's Reference Paper, the Panel thus found that the uniform settlement rate under the ILD Rules requires practices by a major supplier that are anti-competitive within the meaning of Section 1 Reference Paper.[234] The Panel's line of reasoning adopted the US approach as follows:

> [A]nti-competitive price fixing by telecommunications suppliers cannot be unilaterally exempted from the scope of Section 1 by a government requirement imposing such price fixing. To find otherwise would enable WTO Members unilaterally to detract from the effectiveness of their Section 1 obligations to maintain competitive safeguards by requiring such anti-competitive practices.[235]

With regard to Mexico's "proportionate return" system, the Panel found that this has effects tantamount to those of a market arrangement between suppliers, which the Panel found earlier to be "anti-competitive practices" within the meaning of Section 1 of the Reference Paper. Thus

[233] *Mexico-Telecommunications*, para. 7.262.
[234] *Ibid.*
[235] *Ibid.*

the proportionate return system under the ILD Rules requires practices by a major supplier that limit rivalry and competition among competing suppliers and are therefore "anti-competitive" within the meaning of Section 1 Reference Paper.[236]

3) Has Mexico maintained "appropriate measures"?

Having determined that the practices were anti-competitive, the Panel examined whether Mexico has maintained "appropriate measures" to prevent them. The Panel held that since Mexico maintained measures which *legally required* anti-competitive conduct by a major supplier, Mexico has failed to maintain appropriate measures to prevent such practices.[237] Mexico has thus failed to fulfill its obligations under Section 1 of its Reference Paper.[238]

The Panel, however, was careful to stress that their interpretation of Section 1 of the Reference Paper does not unduly limit the broad regulatory autonomy of WTO Members.[239] They pointed out that Mexico's case with respect to the ILD Rules that required anti-competitive practices were exceptional and that different WTO Members may interpret "anti-competitive practices" in Section 1 of the Reference Paper differently. Thus, the Panel stated that its finding is limited to the interpretation of Mexico's GATS obligations under Section 1 of its Reference Paper, with respect to the US, and with respect to the very specific anti-competitive

[236] *Mexico-Telecommunications*, para. 7.264.
[237] *Mexico-Telecommunications*, para. 7.266.
[238] *Mexico-Telecommunications*, para. 7.269.
[239] See also Chapter 3, Section IV.7 on GATS and domestic regulation.

measures in the relevant market for telecommunications services discussed in this particular dispute.[240]

Nonetheless, the Panel had to decide on competition law issues. This called for suggestions that a WTO framework for competition law is more pressing now than it was because there is need for some rule of law in the WTO on the matter. Otherwise WTO panels would be left to rule on competition policy issues despite the absence of a comprehensive set of international rules on competition, and thereby creating situations of ad hoc rulings by panels.[241]

(f) Issues of access to and use of public telecommunications transport networks and services: GATS Annex on Telecommunications

The US's third allegation against Mexico was that Mexico failed to ensure that US service suppliers have access to or use of "public telecommunications transport networks and services" (PTTNS) in Mexico on reasonable terms and conditions, within the meaning of Section 5(a) of the Annex on Telecommunications. The US also claimed that Mexico failed to ensure the US facilities-based operators and commercial agencies[242] have access to and use of *private* leased circuits as required under Section 5(b) of the Annex.

[240] *Mexico-Telecommunications*, paras. 7.267-8.
[241] See Rajeev Sharma and Jason Roshychuk, "The Collision of Trade and Competition Law: Assessing the Aftermath of the WTO *Telmex* Decision", 25 June 2004, http://www.heenanblaikie.com; and R.D. Anderson and Peter Holmes, "Competition Policy and the Future of the Multilateral Trading System", 5(2) *JIEL* (2002), pp. 531-563.
[242] Commercial agencies are defined in Mexico's Schedule as "[a]gencies which, without owning transmission means, provide third parties with telecommunications services by using capacity leased from a public network concessionaire". Commercial agencies are thus equivalent to non-facilities based telecommunications suppliers. See Appendix X.

To determine whether Mexico has met its obligation under Section 5 of the Annex on Telecommunications, two main questions needed to be answered: 1) Whether the Annex imposes obligations on Mexico to ensure access to and use of PTTNS for the supply of the basic telecommunications services scheduled by Mexico? 2) If yes, then whether Mexico has fulfilled its obligations under Section 5 of the Annex?

1) Whether the Annex imposes obligations on Mexico?

a) Does the Annex apply to the supply of basic telecoms services?

The issue is whether the Annex applies to access to and use of PTTNS for the *supply* of basic telecoms services or *only* for access to and use of PTTNS as a *transport means* for *other* economic activities and *not* for the supply of basic telecoms services? The Panel established the scope of the Annex by interpreting Section 2 of the Annex which provides that the Annex shall apply to "all measures of a Member that affect access to and use of public telecommunications transport networks and services". The Panel came to the conclusion that since Section 2 of the Annex does not specify that the provision is limited to measures affecting access to and use of PTTNS by only *certain* services or service sectors, Section 2 suggests "the scope of the Annex includes *all* measures that affect access to and use of [PTTNS] with regard to *all services*, including basic telecommunications services".[243]

Furthermore, Section 1 of the Annex recognizes the dual role of telecommunications services and the language of Section 1 does not

[243] *Mexico-Telecommunications*, para. 7.278.

suggest that the Annex covers only access to and use of PTTNS as an underlying means of transport for other services and not also for the supply of basic telecoms services.[244] More specifically, however, Section 5 of the Annex explicitly seeks to ensure that access to and use of PTTNS is granted "for the supply of a service included in [a Member's] Schedule". Thus, if a Member listed basic telecoms in its schedule, Section 5 dictates that the Annex applies to basic telecoms. The Annex does not exclude basic telecoms from its scope, as Mexico argued, but the Annex applies to measures of a Member that affect access to and use of PTTNS by basic telecommunications suppliers of any other Member.[245]

b) Does Section 5 of the Annex apply to basic telecoms commitments scheduled by Mexico?

The Panel found that Section 5 of the Annex only applies to access to and use of PTTNS for the supply of a service *included in a Member's Schedule*,[246] and *nothing* in the Annex shall be construed to "require a Member to authorize a service supplier of any other Member to establish, construct, acquire, lease, operate or supply telecommunications transport networks or services, *other than as provided for in its Schedule*".[247] Thus the Annex does not create a right to supply a service where no commitments for that service exist.[248]

The Panel's earlier examination of Mexico's Schedule found that Mexico committed to basic telecoms services supplied cross-border on a facilities-basis, but Mexico did *not* commit to cross-border supply of

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244 *Mexico-Telecommunications*, para. 7.280. See also Sections I.1 and II.2 above.
245 *Mexico-Telecommunications*, para. 7.288.
246 Annex on Telecommunications, Section 5(a).
247 Annex on Telecommunications, Section 2(c)(i)), (emphasis added).
248 *Mexico-Telecommunications*, para. 7.293.

telecoms services supplied over private-leased lines (non-facilities basis).[249] Mexico has also committed to basic telecoms services supplied on a non-facilities basis through commercial presence (mode 3) in Mexico.[250] Thus, Section 5 of the Annex applies to Mexico's scheduled commitments on the cross-border supply of basic telecoms services on a facilities-basis[251] and the supply of basic telecoms on a non-facilities basis through commercial presence.[252]

2) Has Mexico fulfilled its obligations under Section 5 of the Annex?

To determine whether Mexico has fulfilled its obligations under the Section, the Panel embarked on a lengthy interpretation of Section 5 of the Annex.

The Panel held that the structure of Section5 of the Annex is such that paragraphs (a) through (f) of Section 5 inform each other, and that each paragraph cannot be determined in isolation of the others. Thus, the analysis of a claim under paragraph (a) requires an examination of whether any conditions that are imposed on access to and use of PTTNS are "necessary" in the meaning of Section 5(e) of the Annex.[253] Section 5(e) only allows conditions that are "necessary" to achieve the three policy objectives set out in subparagraphs (i) to (iii) of that Section. Paragraph (f) contains an *illustrative list* of types of regulatory conditions that *may be* imposed if "necessary" to achieve a policy goal mentioned in paragraph (e).

The Panel inferred that whenever a condition is "necessary" under

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249 *Mexico-Telecommunications*, para. 7.91. See Section III.4(c) above.
250 *Mexico-Telecommunications*, paras. 7.377-7.378, 7.381. See Appendix X.
251 *Mexico-Telecommunications*, paras. 7.294-5.
252 *Mexico-Telecommunications*, para. 7.378.
253 *Mexico-Telecommunications*, para. 7.309.

paragraph (e), it must, in addition, be "reasonable and non-discriminatory" under paragraph (a). Conversely, if a condition is not "necessary" to fulfill at least one of the three policy objectives set out under subparagraphs (i) to (iii), paragraph (e) *prohibits* the imposition of such a condition, which suggests that there may be no need to analyse in that case whether that condition would otherwise be "reasonable and non-discriminatory".[254]

The Panel also concluded that an obligation arises for a Member under paragraph 5(b) subject to any term or condition that a Member may impose in a manner consistent with the provisions of paragraphs (a) and (e).[255]

a) US claims under Section 5(a)

The US had three major claims under Section 5(a) of the Annex. First, the US claimed that Mexico has failed to ensure that cross-border suppliers of facilities-based basic telecoms services from the US into Mexico were accorded access to and use of PTTNS on reasonable terms and condition. Second, this failure on Mexico's part was due to the charging of above-cost rates to foreign suppliers for access to and use of the networks and services provided by Mexico's long-distance operators, thus amounting to "unreasonable terms and conditions". Third, the failure was also attributable to the requirement that foreign suppliers must negotiate exclusively with Mexico's long-distance licensee with the greatest percentage of out-going long-distance market share over the preceding six months and prohibiting foreign suppliers from concluding alternative

[254] *Mexico-Telecommunications*, para. 7.306.
[255] *Mexico-Telecommunications*, para. 7.309.

terms and conditions with other Mexican suppliers of such networks and services,[256] all amounting to "unreasonable terms and conditions".

There are four elements to Section 5(a) with respect to the granting of "access to and use of" referred to in this provision.

i) "any service supplier of any other Member"

The Panel held that facilities based suppliers (such as AT&T, WorldCom/MCI and Sprint) as well as commercial agencies (non-facilities based suppliers) supply or are seeking to supply the services at issue, and are suppliers of "any other Member", in this case, the US.[257]

ii) with respect to "public telecommunications transport networks and services"

Mexico's Schedule requires that the cross-border supply of telecoms services be routed through the facilities of a Mexican concessionaire. The Panel held that Mexican concessionaires are clearly "public telecommunications transport networks and services" as defined in Section 3 of the Annex. Thus the facilities of the Mexican concessionaires which are relevant to the US claim with respect to access and use *are* "public telecommunications transport networks and services".[258]

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[256] ILD Rules 3, 6, 10, 13, 22 & 23.
[257] *Mexico-Telecommunications*, para. 7.314.
[258] *Mexico-Telecommunications*, para. 7.315.

iii) "for the supply of a service included in its Schedule"

The Panel had earlier found that Mexico has made market access commitments, subject to a routing requirement, and full national treatment commitments on the supply of basic telecommunications services. Therefore, even under a restrictive reading of the obligation under paragraph (a), these services are included in Mexico's Schedule. Furthermore, the Panel had found that the Annex applies to the access to and use of PTTNS for the supply of *all* transportation services, including basic telecoms services. The nature of the basic telecoms services at issue, as inscribed in Mexico's scheduled, includes services which require suppliers to link their networks to those of other suppliers. The definition of public telecoms transport service in Section 3(b) of the Annex also speaks of a transmission "between two or more points". Thus the Panel held that foreign suppliers of basic telecoms services require access to and use of PTTNS *for the supply* of their services.[259]

iv) "on reasonable terms and conditions"

The US claim of unreasonableness concentrated on the rates charged for access to and use of PTTNS, although Section 5(a) Annex does not contain the term "rates", unlike Section 2 of the Reference Paper.

The Panel pointed out that although paragraph (a) speaks of "terms and conditions", paragraph (e) refers only to "conditions". But since paragraphs (a) and (e) inform each other, the Panel analyzed whether

[259] *Mexico-Telecommunications*, paras. 7.317 and 7.319.

"rates" are "terms", or whether they are "conditions". Building on their earlier analysis, the Panel stated that if the rates are terms, they would have to meet the "reasonable" standard in Section (a); if they are "conditions" they would, in addition, have to meet the "necessary" standard in Section (e).

The Panel determined that although the words "terms" and "conditions" are closely related, and are frequently used concurrently, the ordinary meaning of the word "terms" suggests that it would include pricing elements, including rates charged for access to and use of public telecoms transport networks and services.[260] However, according to the Panel, pricing measures do not appear to fit within the meaning of the language of section 5(f), which lists examples of "conditions".[261] Thus, the Panel determined that rates charged for the access to and use of PTTNS are "terms" within the meaning of Section 5(a), but not "conditions" within the meaning of Section 5(e).[262]

Furthermore, the Panel disagreed with Mexico's argument that a reading of a pricing element into the analysis of reasonable terms in Section 5(a) would render parts of Section 2.2(b) of Mexico's Reference Paper *inutile*: reasoning that although there are differences in the scope, level of obligations and specific detail provided, the Reference Paper and the Annex overlap to a certain degree and the Reference Paper commitments do not subtract from the Annex or render it redundant.[263] The Panel therefore held that access to and use of PTTNS on "reasonable" terms includes questions of *pricing* of that access and use.[264]

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260 *Mexico-Telecommunications*, para. 7.325.
261 *Mexico-Telecommunications*, para. 7.326.
262 *Mexico-Telecommunications*, para. 7.327.
263 *Mexico-Telecommunications*, para. 7.332-3.
264 *Mexico-Telecommunications*, para. 7.333.

The Panel held that "reasonable" pricing must be determined on a case-by-case basis.[265] In Mexico's case, the Panel held that rates for access to and use of PTTNS may still be reasonable even if generally higher than cost-oriented interconnection rates in terms of Section 2.2(b) of the Reference Paper. The Panel reasoned that if this were not the case, then it would have been redundant for Members to have made commitments additional to Annex obligations on access, especially on cost-oriented rates for interconnection, one of the most important forms of access. Furthermore, those Members who took Reference Paper commitments did so in order to establish specific disciplines only for major suppliers, and especially for interconnection. This would not have been necessary if Members already had an obligation to ensure that all suppliers, major or not, would have to provide cost-based access and use, including interconnection.[266]

Having earlier found that the rates charged to interconnect US suppliers of the services at issue to PTTNS in Mexico exceeded cost-oriented rates by a *substantial margin* (70%), and whose uniform nature excludes price competition in the relevant market of the telecoms services bound under Mexico's Schedule, the Panel held that these rates do not provide access to and use of PTTNS "on reasonable ... terms". Thus, Mexico has failed to meet its obligations under Section 5(a) of the GATS Annex by failing to ensure that service suppliers of the US are accorded access to and use of PTTNS in Mexico on reasonable terms.[267]

However, the Panel failed to determine by *what margin* a rate exceeds cost-based rates would it then constitute "unreasonableness". Mexico's

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265 *Mexico-Telecommunications*, para. 7.328.
266 *Mexico-Telecommunications*, para. 7.334.
267 *Mexico-Telecommunications*, para. 7.335.

margin was, as determined by the Panel, by about 70%.[268] What if it was by 60% or 45%, would they be "unreasonable"? The Panel did not provide a yard stick to measure what could be deemed "reasonable" rates. The issue of cost-oriented rates is crucial and central to the liberalization and promotion of competition in telecommunications. The Panel having based its decision on such an important issue predominantly on US methodologies of calculating cost-oriented rates calls for the suggestion that a WTO-negotiated and agreed formula on cost-based calculation would provide a useful tool to future dispute cases on telecommunications – one that would add to the clarity of WTO rules and commitments.

b) US claims under Section 5(b)

The US claimed that Mexico has failed to ensure that *non-facilities* based, *commercially present* suppliers (commercial agencies) have access to and use of *private leased circuits*, and are permitted to connect these circuits to PTTNS or with circuits of other service suppliers.

There are five elements to Section 5(b) of the Annex to which the Panel had to consider. First, whether Mexico committed in effect to allow commercial agencies to supply the services at issue through commercial presence. Second, whether Mexico's commitments on the supply of the services at issue by commercial agencies through commercial presence include the *supply of international telecoms services* (from Mexico to US) through mode 3. Third, whether Mexico has ensured access to and use of *private leased circuits*. Fourth, whether Mexico permits interconnection of

268 See *Mexico-Telecommunications*, para. 7.203

private leased circuits. Fifth, Section 5(b) obligation is subject to Sections 5(e) and (f).

i) whether Mexico has a commitment in effect to allow commercial agencies to supply the services at issue through commercial presence

Mexico has included mode 3 commitments in its Schedule with respect to services supplied by "commercial agencies". It has entered "none" in the national treatment column, and inscribed limitations in the market access column as follows:

> A permit issued by the SCT is required. Only enterprises set up in accordance with Mexican law may obtain such a permit ... The establishment and operation of commercial agencies is invariably subject to the relevant regulations. The SCT will not issue permits for the establishment of a commercial agency until the corresponding regulations are issued.[269]

Mexico argued that this limitation established a "zero quota" on mode 3 access for commercial agencies, which amounts to a market access limitation under GATS Article XV:2(a).[270]

It is commonly understood that the list of limitations in GATS Article XVI:2(a) is exhaustive.[271] The Panel did not confirm this in explicit terms but it could be inferred from the Panel's analysis that it took the view that the list is exhaustive.[272] The Panel determined whether Mexico's inscription in its market access column did indeed amount to a limitation on market access by examining whether Mexico's inscription falls into one of the six categories of limitations in Article XVI:2(a), without considering

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[269] Mexico: Schedule of Commitments, GATS/SC/56/Suppl.2. See Appendix X.
[270] *Mexico-Telecommunications*, para. 7.349.
[271] See discussion on market access in Chapter 3, Section IV.6.
[272] See *Mexico-Telecommunications*, paras. 7.354-7.361.

whether if it did not fall within the six categories the inscription could still amount to a limitation on market access.

The Panel held that the wording of Mexico's inscription in its market access column, that "permits for the establishment of a commercial agency [will not be issued] until the corresponding regulations are issued" does not specify that a numerical *quota* was to be imposed on the issuance of permits. But rather the sentence, the Panel held, seems to introduce a *temporal* qualification as to *when* establishment will be permitted – namely, after the issuance of the regulations.[273]

The Panel found that *temporal* qualification to market access – such as dates for entry into force or for the implementation of commitments – does not fall within the six categories in GATS XVI:2(a), and thus suggests that temporal limitations cannot constitute limitations to market access under GATS Article XVI:2.[274] The Panel further supported its finding as follows:

> The separate listing of temporal elements of entry into force and implementation in Article XX:1 confirms, in our view, that temporal elements are not part of the substantive elements that can be market access limitations under Article XVI:2.[275]

Consequently, the Panel found that Mexico's scheduled requirement that commercial agencies obtain permits, and that these permits are based on regulations, is a *temporal limitation* that is not a market access limitation within the meaning of Article XVI:2(a).[276]

The Panel then proceeded to determine what meaning the inscription does have. The Panel held that since Mexico has not included a date in its Schedule to indicate that its specific commitment on commercial agencies

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[273] *Mexico-Telecommunications*, para. 7.357.
[274] *Mexico-Telecommunications*, paras. 7.357-8.
[275] *Mexico-Telecommunications*, para. 7.361.
[276] *Mexico-Telecommunications*, para. 7.362.

was to enter into force at a different date from 5 February 1998 (date of entry into force of ABT), Mexico's entry relates to the time-frame for *implementation*, and not the entry into force of commitments.[277] The Panel further went on to interpret that a time-frame is not open-ended and does not leave the time of the occurrence in doubt.[278] GATS Article XX:1(d) requires, with respect to sectors where commitments are undertaken, that each schedule specify "where appropriate the time-frame for implementation of such commitments."

The Panel held that this provision, the objective of which is to ensure clarity and precision with regard to the scheduling of commitments, cannot be interpreted to allow a window of discretion with regard to temporal aspects of these commitments that could erode the practical value of a commitment.[279] Thus, GATS Article XX:1(d) requires the specification of a time-frame for implementation should a Member wish to implement a commitment *after* its entry into force. Where a Member does not specify a time-frame, implementation must be deemed to be concurrent with the entry into force of the commitment. Thus, with regard to Mexico's Schedule, the Panel found that,

> The entry in Mexico's Schedule does not contain language that expresses a condition "whether" regulations and permits would be issued, but only "when" the permits would be issued [...] Even if Mexico had needed time to complete the issuance of the regulations beyond the time of entry into force of its commitment on 5 February 1998, Mexico should, at the very minimum, have initiated that process leading to the issuance of the regulations. There is no evidence, however, that Mexico has taken *any* steps to comply with its commitment. We do not consider it necessary to rule on the length of a time period within which the implementation of Mexico's commitment might reasonably have been concluded, as more than five years have passed since the entry into force of Mexico's commitment, and Mexico still has indicated no date by which it intends to issue the relevant regulations and permits. Therefore, we find that Mexico's refusal to authorize the supply of services by commercial agencies is inconsistent with the market access commitment inscribed in its schedule.[280]

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[277] *Mexico-Telecommunications*, para. 7.364.
[278] *Mexico-Telecommunications*, para. 7.366.
[279] *Mexico-Telecommunications*, para. 7.368.
[280] *Mexico-Telecommunications*, para. 7.371.

The Panel's finding reinforces the importance of precision and clarity in scheduling commitments, discussed in Chapter 3, Sections IV.2, IV.5 and IV.6:

> Members must be able to infer from each schedule the precise conditions for market access, national treatment and, where inscribed in the schedule, any additional commitments a Member has undertaken. By the same token, specificity as to when a commitment enters into force and when it has to be implemented is equally important. A market access commitment that leaves in doubt when a commitment takes effect is of little practical value. Unlike for the implementation of GATT tariff reductions which entered into force on 1 January 1995, and for which paragraph 2 of the Marrakesh Protocol provided a time-frame for implementation, the dates of entry into force and implementation of specific commitments under the GATS coincide in principle.[281]

ii) whether Mexico's commitments on the supply of the services at issue by commercial agencies through commercial presence include the *supply of international telecoms services* (from Mexico to US) through mode 3.

The Panel held that the definition of commercial presence as defined in GATS Article XXVIII and the supply of services through commercial presence as defined in GATS Article I:2(c), make explicit the location of the service supplier – that is, in the *territory of any other Member.* The Panel further reasoned that the definition is silent with respect to any other territorial requirement (as in cross-border supply under mode 1) or nationality of the service consumer (as in mode 2, consumption abroad). Thus, the supply of a service through commercial presence would therefore not exclude a service that originates in the territory in which a commercial presence is established (such as Mexico), and is delivered into the territory of any other Member (such as the US).[282]

281 *Mexico-Telecommunications*, para. 7.367.
282 *Mexico-Telecommunications*, para. 7.375.

The Panel held that since Mexico did not exclude international telecoms services in its sector column, or elsewhere in its Schedule, from the scope of services that commercial agencies may supply, it can be assumed that Mexico's mode 3 commitment at issue includes the supply of basic telecommunications within Mexico, and from Mexico into any other country.[283]

iii) access to and use of *private leased circuits*

The Panel then considered whether Mexico fulfilled its obligations in Section 5(b) Annex to ensure that suppliers of any other Members have access to and use of any PTTNS offered within or across Mexico's border, including private leased lines. The Panel found that Mexico has committed to allow commercial agencies to use leased capacity for the supply of the services at issue. And as Mexico indicated no restriction on the geographic market (local, long-distance, international) for the services that may be supplied by the commercial agencies established in Mexico, and no routing restriction was inscribed (as in the case of cross-border supply) for the supply through commercial presence, the Panel considered that Mexico has undertaken commitments on the supply of the services at issue by commercial agencies through commercial presence, for which access to and use of private leased circuits is not only relevant but, by Mexico's own definition in its Schedule, is essential.[284]

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283 *Mexico-Telecommunications*, para. 7.377.
284 *Mexico-Telecommunications*, para. 7.381.

Therefore the Panel found that Mexico has failed to ensure access to and use of private leased circuits for the supply of the committed services in a manner consistent with Section 5(b) of the Annex.[285]

iv) interconnection of private leased circuits

This involves Mexico's ILD Rule 3 which states:

> Only *international gateway operators* shall be authorized to interconnect directly with the public telecommunications networks of other countries' operators for the purpose of carrying international traffic. (emphasis added)

ILD Rules require that "international gateway operators" be a facilities-based supplier, and must always be a "concessionaire". However, a commercial agency, by its definition in Mexico's Schedule, can never be a concessionaire and thus a commercial agency can never be an international gateway operator. The Panel therefore found that ILD Rule 3 prohibits commercial agencies to interconnect "directly with the public telecommunications networks of other countries' operators for the purpose of carrying international traffic."[286]

v) obligation of section 5(b) Annex is subject to provisions of sections 5(e) and (f)

The Panel found that Mexico has undertaken mode 3 commitment on the supply of telecoms services at issue by commercial agencies. This commitment does not exclude the supply of non-facilities based service from Mexico into any other country. The Panel noted that the obligation in Section 5(b) is subject to Sections 5(e) and (f). However, the Panel found

[285] *Mexico-Telecommunications*, para. 7.381.
[286] *Mexico-Telecommunications*, para. 7.384.

that ILD Rule 3 does not impose a condition "necessary" to achieve the objective set out in Section 5(e)(iii), but instead it prevents interconnection to private leased circuits for a service on which a specific commitment has been undertaken. Thus, the Panel held that ILD Rule 3 is inconsistent with Mexico's obligations under Section 5(b) Annex.[287]

c) Invocation of Section 5(g) of the Annex

Mexico argued that it is necessary to condition access to its networks for the purpose of strengthening its domestic infrastructure in accordance with Section 5(g) of the Annex. This is a developing country provision: it allows developing countries, consistent with their level of development, to place reasonable conditions on access to and use of PTTNS - such conditions must be specified in a Member's schedule.

The Panel held that Mexico did not inscribe any limitations referring to Section 5(g) of the Annex in its Schedule therefore Section 5(g) does not permit Mexico to depart from specific commitments which it made.[288]

The Panel's decision is particularly negative for developing countries. The Panel stated that in order to benefit form Section 5(g) of the Annex, countries would have had to refer to it or have named their development objectives when they made their telecoms commitments.[289] According to Gould, since virtually no developing country has done this, the Panel rendered the provision effectively useless.[290] It must be pointed out

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287 *Mexico-Telecommunications*, para. 7.385.
288 *Mexico-Telecommunications*, para. 7.388.
289 *Ibid.*
290 Ellen Gould, "Telmex Panel Strips WTO of Another Fig Leaf", CCPA Briefing Paper Trade and Investment Series, Vol. 5(2), July 2004.

however that Section 5(g) clearly states that "such conditions shall be specified in a Member's Schedule". The Panel's decision, although harsh from a developing country perspective, is merely upholding the provisions of Section 5(g).

The Panel held that Mexico has failed to meet its obligations under Section 5(b) of the Annex by failing to ensure that commercially present commercial agencies of the US have access to and use of *private leased circuits* and are permitted to interconnect those circuits to public telecoms networks and services or with circuits of other service suppliers.[291]

The consequence of this ruling by the Panel is that foreign competitors could now enter the Mexican telecoms market, through commercial presence, and rent Telmex's equipment to provide competing services. This will make it easier for smaller foreign companies to enter the Mexican market using existing infrastructure. The result of this is greater competition for Mexico's telecommunications services.

In summary of *Mexico-Telecommunications*, the Panel found that Mexico has failed to meet its GATS commitments under Section 2.2(b) of its Reference Paper, Section 1.1 of its Reference Paper and Section 5(a) of the Annex with respect to cross-border supply of basic telecommunications services on a facilities-based. Mexico has also failed to meet its obligations under Section 5(b) of the Annex by not permitting commercially present suppliers from accessing private leased lines within or across Mexico's border and to interconnect these circuits to PTTNS. The Panel, however, held that Mexico did not violate its commitments in Section 2.2(b) of its Reference Paper and Sections 5(a) and (b) of the Annex

[291] *Mexico-Telecommunications*, para. 7.389.

with respect to cross-border supply of basic telecommunications services on a non-facilities basis.

5. *Concluding Remarks*

The decision in *Mexico-Telecommunications* has implications for both developed and developing WTO Member countries. First, the crucial significance of the decision is that it was based and won almost entirely on the Reference Paper and the Annex on Telecommunications. In addition, the Reference Paper is based on "competition law" principles, but the WTO contains no agreement or guideline on competition law. The Panel in *Mexico-Telecommunications* thus "seized jurisdiction over some competition law issues".[292] For instance, the Panel decided that cartel behaviours of price fixing are equivalent to anti-competitive practices although not listed in Section 1 of the Reference Paper. The Panel also had to determine the "relevant market" according to competition law principles.

The Panel, however, had to rule on competition issues because they were called upon to do so – and more instances will arise in the future where cases will be brought before the WTO whereby there will be elements of competition law that require interpretation by the Panel presiding over the case. Because this interpretation is left to panels with no guidelines to follow, developing countries and developed countries alike could lose faith in the ability of the WTO to achieve effective trade liberalization in telecommunications services through multilaterally agreed rules.

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[292] R. Sharma and J. Rosychuk, (2004).

It has been suggested that the *Mexico-Telecommunications* decision should convince "nations which have until now resisted codifying trade and competition principles" that there should be renewed negotiations on an agreement on competition policy.[293] This agreement would at least provide a more "concrete agreement on competition policy" which arguably is more preferable to panel judicial interpretations which may be far less satisfactory.[294] Thus future developments in the WTO could require a guideline or framework on competition law and policies to work alongside telecommunications liberalization as ultimately, it is crucial to be able to interpret correctly the important but flexibly-worded pro-competitive principles when making WTO commitments on telecommunications and when adjudicating on the disputes arising from them.

Second, *Mexico-Telecommunications* demonstrates the possibility of the WTO becoming an "uberregulator"[295] of telecommunications trade. This could force developing countries to hold back from fully committing to the WTO framework on telecommunications liberalization, in particular the pro-competitive principles of the Reference Paper. Worse still, the effectiveness of the WTO system could be undermined by developing countries, such as India, refusing to make further liberalization commitments on trade in services for fear of being held accountable in the WTO dispute settlement system (as Mexico was) – and fear of having their domestic policies (such as universal service and its funding through cross-subsidization from high accounting rates) overruled by international commitments.

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293 *Ibid.*
294 *Ibid.*
295 J.G. Sidak and H.J. Singer (2004).

Third, the Panel's ruling on international interconnection and the accounting rate regime will have significant implications to in particular to developing countries' policies on international telecommunications, especially with regard to the traditional accounting rate regimes. The Panel's decision, for instance, will affect those WTO Members who have fully committed to the Reference Paper but still maintains accounting rates that are significantly above costs. These Members would have to ensure that no government measures are in place which permits above-cost interconnection rates. The Panel's decision will particularly have an impact on developing countries' hard currency revenue earned from high accounting rates. Mexico, for example, received around $1 billion in settlement payments from the US each year since 2000.[296] The Panel's decision required Mexico to make major changes to its current international settlement rates regime and reduce the accounting rates it currently charges to near cost-based in line with its WTO commitments. Nonetheless, it is hoped that the competitive commercial negotiation of international settlement rates resulting from the revised ILD Rules, implementing the ruling, will result in reasonable and cost-oriented rates.

Fourth, developing countries are going to find themselves incorporating/implementing US and EC policies and legal concepts on the liberalization of telecommunications services and competition law if they commit fully to the WTO rules on services liberalization and in particular to the principles contained in the Reference Paper. This is one of the consequences of the Panel decision in *Mexico – Telecommunications*, where they used US competition law to decide whether Telmex was a major

[296] *Supra* n. 141.

supplier or not in the "relevant market",[297] and used interpretations of certain telecoms terms – such as "interconnection" – found in US and EC telecoms regulatory frameworks. However, this should not be a reason for developing countries not to commit fully to the WTO liberalization of telecommunications services.

Mexico-Telecommunications raises some interesting questions for consideration. The US brought the case against Mexico for alleged violations by Mexico of its WTO commitments in basic telecommunications. However, there are other countries, for example Canada and Japan, whose policies on telecommunications might not be wholly consistent.[298] The US has not brought a case against these countries. Why is that the case? What was the goal of the US for bringing the case against Mexico? Was the US trying to enforce compliance with WTO rules on basic telecommunications through the WTO dispute settlement system? Or perhaps was it trying to use the WTO dispute settlement system to provide jurisprudence or set precedents in the area of telecommunications services? Or was the goal of the US in bringing the case to get the WTO to fill the gaps and resolve ambiguities in the treaty text? Or was the US using this case against Mexico to get a WTO ruling in favour of the US and thereby provide a reasoned judgment to enhance broader public acceptance of the applications and development of the rules for the liberalization of trade in telecommunications services.[299]

It would seem that all the goals above underpinned the US's move in bringing a case against Mexico before the WTO panel and thus seeking resolution to the US-Mexico telecoms dispute saga that began in 1997.

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[297] See Mexico-Telecommunications, paras. 7.149-7.152.
[298] See USTR, *Results of 2003 "Section 1377" Review.*
[299] These goals underpinning dispute settlement systems are from John Jackson's draft outline given at the 3rd Annual WTO Conference, 14 May 2003, Senate House, London, UK.

The last goal is achieved by the Panel's decisions in favour of the US which give credibility to US's regulatory policies and principles on competitive safeguards, the independent regulator and most importantly for telecoms, the concept of cost-oriented interconnection rates.

The US was certainly trying to enforce compliance of WTO rules on basic telecommunication services. It has always been a strong advocate of liberalization of telecommunications services, the opening up of Member countries' telecoms markets and the promotion of competition in those markets.[300] Mexico, a huge market for US telecommunications services operators, is an important market to the US with enormous gains to be made from the liberalization of Mexico's telecommunications industry and rules based on market and competition principles that will allow US operators to compete with the Mexican giant Telmex on an equal footing.

The difficulty for Mexico, although a party to the NAFTA and aspires to compete in world trade on the same footing as Canada and the US, is that it is nonetheless still a developing country. Mexico may have made international commitments in regional agreements and multilateral agreements like the WTO but the volatility that often characterizes a developing country's political and economic system makes it difficult for such a country, even with initial good intentions to reform towards a market economy, to implement and then enforce the multilateral commitments that it has embarked upon. Mexico's telecommunications sector, like most other countries', was served by a monopoly until the wave of privatization and liberalization of the telecommunications industry swept the globe beginning in the 1990s. Mexico adopted new laws and

[300] See Chapter 2, Section VI.

rules over the past decade to introduce competition to the Mexican telecoms sector. Enforcement, however, has not been easy or straight forward. Privatization of Telmex alone does not satisfy Mexico's obligations under the WTO to promote the liberalization of trade in the telecommunications sector, nor does it mean the market automatically becomes truly competitive.[301]

The difference in developing country regulation from developed country is that the realities of corruption and non-transparent political dealings continue to persist in developing countries to make the move from monopoly to competitive markets in telecommunications especially difficult. Mexico's telecommunications industry, for instance, is still dominated by Telmex, which is not just a powerful oligopolistic corporate entity but more the strong personality of its chairman and largest shareholder, Carlos Slim, Mexico's and Latin America's wealthiest man. Not only is Carlos Slim the most successful businessman in Latin America, he was also a kingmaker in the Institutional Revolutionary Party (PRI) which held power for seven decades until President Vicente Fox took office in December 2000.[302]

It could be argued that the US recognized the political realities infecting Mexico's telecommunications industry and because Mexico is its biggest market for the export of telecoms services, the US took action before the WTO dispute system in a move to compel Mexico to comply with its multilateral commitments. The Mexican government and Cofetel have continuously failed to do this, and the US no longer believed they would be able to do in the future without a definitive decision from the WTO.

[301] Nagle (2002), p. 248.
[302] Nagle (2002), p. 208.

This first WTO telecommunications services case demonstrates the US executing its leadership role in enforcing commitments towards the liberalization of telecommunications services and more generally trade in services.[303] The US is determined to ensure that the WTO Reference Paper is utilized as an established and clear set of regulatory principles to be applied regularly and faithfully by all WTO Members. In order to advance the global liberalization of telecommunications services, Members who have committed to open up their telecommunications market under the auspices of the WTO must abide by the negotiated and agreed multilateral rules by implementing them into their domestic regime, encouraging competition within their telecommunications markets, and adhering to the regulatory principles to which they have committed. The signing up of more Members to commitments on telecommunications services, especially from developing countries, would further advance the liberalization process.

303 Cf. the recent services case of *US-Gambling*, WT/DS285,R, where the case is against the US.

Chapter 5

The Liberalization of Telecommunications in a Developing Country: the Case of India

Like most other countries around the world the Indian telecommunications industry was, prior to the introduction of competition and liberalization, a state monopoly. Liberalization of the telecommunications sector began in 1992 with the introduction of limited competition in value-added services and in cellular telephony. Major reforms took place in 1994 and 1999, and an independent, albeit weak, regulator was established in 1997. Today, competition from private sector companies has been allowed although the biggest telecommunications providers in India are majority state-owned. Meanwhile, within the WTO framework, India has made very limited commitments towards the liberalization of telecommunications services. Nonetheless, it has autonomously liberalized many sections of its telecoms industry since the conclusion of the Uruguay Round in 1994 and the subsequent Agreement on Basic Telecommunications (ABT).

India is moving towards competition but it must be recognized that developing countries such as India do not have the same market economy dynamics as exist in developed countries. For India, as for many other developing countries introducing competition into economic sectors of state monopolies, the process of privatization and de-monopolization is a gradual process that requires a certain degree of flexibility.[1] In the

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[1] WTO, WGTCP, "Communication from India: The Impact of State Monopolies, Exclusive Rights and Regulatory Policies on Competition and International Trade", WT/WGTCP/W/110, 16 November 1998, para. 4.

international arena, India is an active participant in the WTO and it has taken steps to liberalize its telecommunications sector in accordance with WTO rules. It must be recognized, however, that deregulation and privatization of any traditionally reserved sector is not without domestic political difficulties.

This chapter studies the telecommunications industry in India to provide insight into the development and circumstances of the liberalization of telecommunications in a fast-growing developing country. The first half of the chapter examines the position of developing countries in the WTO. It begins by looking at the special treatment given to developing countries in the context of the WTO Agreements, with particular reference to the GATS. It then examines the liberalization of trade in services from the perspective of developing countries followed by an account of their participation in the current services negotiations that commenced in February 2000. Here, the chapter looks at the developing countries' position on services liberalization generally and also at the specific issue of telecommunications. The chapter continues with a background examination of India's current telecommunications structure. It then examines the reform policies in telecommunications over the years, and finally how and to what extent India has implemented its WTO commitments on telecommunications services.

It is clear that the Indian government has been keen to embrace reforms introducing competition into the telecommunications sector. However, the new bill on communications is still very restrictive and continues to maintain heavy government involvement in most aspects of telecoms. India has made limited commitments in basic telecommunications in the WTO at the end of the Uruguay Round and the extended negotiations on basic telecommunications. Furthermore, although India has adopted autonomous liberalizing measures in the telecommunications sector, it has, in its recent offers on trade in services tabled in the current Doha Round, scheduled very few of these autonomous measures as commitments.[2]

I. Developing Countries and the WTO

In the WTO, there is no definition of developed or developing countries. A country nominates itself as either a developed or developing country, although this self-classification is not automatically accepted in all WTO bodies. Developing countries currently make up about two-thirds of the WTO, and India is among them. Least-developed countries (LDCs), however, are defined in a list established by the United Nations. Out of the 49 least-developed countries on the UN list, 30 are Members of the WTO and 9 more are in the process of accession.[3]

The categorization of WTO Members into developing/least-developed countries is important because the WTO Agreements contain provisions dealing with special situations applicable to these countries. These provisions can be found in the GATT, the GATS, the Agreements in Annex 1A of the Marrakesh Agreement Establishing the World Trade Organization (namely, the TBT Agreement, the SPS Agreement, the Agreement on Agriculture) and the Dispute Settlement Understanding with regard to least-developed countries.

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[2] See Appendix IX. See also the Indian Ministry of Commerce's monthly newsletter on the WTO, December Issue, Volume 5(12) at http://commerce.nic.in/wtodec2003.htm#h9.

[3] See WTO website at http://www.wto.org.

GATT 1994 has a special section, Part 4, on Trade and Development which includes provisions on non-reciprocity in trade negotiations between developed and developing countries.[4] Under these special provisions, when developed countries grant trade concessions to developing countries they cannot require developing countries to make matching offers in return. The GATT also enables countries to grant special concessions to developing countries without having to do the same for the entire membership. This is known as "special and differential treatment".[5]

Developing country Members in the WTO did not always have special provisions in the GATT system giving them differential status. The GATT 1947 did not originally recognize the special situation of developing countries since the fundamental principle of the agreement was that rights and obligations should be applied uniformly to all Contracting Parties. Developing countries, including India, between 1948 and 1955 thus participated in tariff negotiations and other aspects of the GATT activities as equal partners.[6] Then, at the Review Session in 1954-55, Article XVIII of the GATT 1947 on governmental assistance to economic development[7] was amended with a view to giving developing countries additional flexibility with regard to several of their obligations in cases where it was necessary for a developing country to promote a particular industry, and

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[4] Part 4 was added to the GATT in 1968 in response to UNCTAD recommendations. Developing countries in 1964 formed UNCTAD to address the special and distinctive economies of the developing countries.

[5] GATT Contracting Parties, Decision of November 28, 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, GATT, 26th Supp. BISD 203 (1980). Now part of GATT 1994, as incorporated by GATT 1994, Section 1(b)(iv).

[6] 11 of the 23 original signatories of the GATT 1947 were developing countries: Brazil, Burma (Myanmar), Ceylon (Sri Lanka), Chile, Cuba, China, India, Lebanon, Pakistan, Southern Rhodesia (Zimbabwe), and Syria.

[7] The original title of Article XVIII GATT, "Government Assistance to Economic Development and Reconstruction", was changed at the Review Session of 1954-55.

also to deal with balance-of-payments problems.[8] Article XVIII became the first article of the GATT designed to grant special privileges to developing countries.[9]

During the Uruguay Round major changes and new provisions were adopted in the multilateral trading system to advance the development of developing countries and increase their participation in world trade. The significant changes beneficial to developing countries include: i) steps taken to establish a fair and market-oriented agricultural trading system through the Agreement on Agriculture; ii) phasing-out of discriminatory restrictions on textiles and clothing and progressive integration of the sector into GATT; iii) establishing that emergency safeguard action must be temporary and normally non-discriminatory and that grey-area measures such as "voluntary export restraints" and "orderly market arrangements" are prohibited; and iv) a more judicial dispute settlement system. These features of the WTO Agreements have contributed to integrating developing countries into the multilateral trading system.[10]

Least-developed countries receive extra attention in the WTO and with regard to dispute settlement, they enjoy a special privilege. Article 24 of the DSU requires WTO Members to "exercise due restraint" in bringing a case against a least-developed country.[11] In addition, a least-developed country can ask the WTO Director General or the Chairman of the Dispute Settlement Body to help settle the dispute through conciliation, mediation or other means.[12] While all other provisions giving special treatment to

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[8] WTO, "High Level Symposium on Trade and Development, Geneva, 17-18 March 1999", Background Document, p.11. (*High Level Symposium 1999*).
[9] Jackson, Davey and Sykes, *Legal Problems of International Economic Relations: Cases, Materials and Text* (1995), p. 1110.
[10] WTO, *High Level Symposium 1999*, p.17.
[11] DSU, Article 24(1).
[12] DSU, Article 24(2).

developing countries are also applicable to least-developed countries, the provisions of Article 24 DSU are limited to LDCs.

1. Special and Differential Treatment in the GATS

In the GATS, there are also provisions giving special attention to the needs of developing countries. However, there are no provisions on "special and differential" treatment like those in the GATT. The GATS provisions on developing countries provide special treatment to developing countries in three main ways.[13] First, there are provisions aimed at increasing their trade opportunities. These are in the three paragraphs that make up Article IV, which is exclusively about encouraging the participation of developing countries in world trade. From the wording, Article IV amounts merely to a "promise" or an intention to help promote developing countries' participation in trade and does not provide an effective means of aiding developing countries through "special and differential" treatment. In practice, this Article has not proved very helpful to developing countries. This is discussed in more detail below.

Second, special treatment is given to developing countries through flexibility with regard to commitments, and use of policy instruments. Article III:4 allows flexibility for individual developing country Member with respect to the time-limit for establishing enquiry points to provide specific information to other Members. Article V:3 provides flexibility with regard to the Article V:1 requirement for substantial sectoral coverage and

[13] LDCs are given further attention in GATS Articles IV:3, XIX:3 and Section 6(d) Annex on Telecommunications.

elimination of discrimination between Members in the context of an agreement liberalizing trade in services entered into by Members.

On progressive liberalization, Article XIX:2 grants,

> appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access inline with their development situation and, when making access to their markets available to foreign service suppliers, attaching to such access conditions aimed at achieving the objectives referred to in Article IV [on increasing participation of developing countries].

Article XIX:2 is one of the most important provisions of the GATS giving special treatment to developing countries. It was the securing of the inclusion of this provision into the GATS that provided the incentive for many developing countries to accept the GATS as part of the WTO package.[14] Similar to Article XIX:2 of the GATS is Section 5(g) of the GATS Annex on Telecommunications permitting developing countries to have the flexibility to attach conditions to the access and use of public telecommunications networks and services by foreign suppliers. It has been suggested that these conditions can be extended to embrace conditions related to preferential pricing for access to and use of developing countries' networks.[15] However, for developing countries to take advantage of this provision they must specify such conditions in their Schedules. This was confirmed by the Panel's ruling in *Mexico-Telecommunications.*[16]

Third, technical assistance is provided to aid developing countries in their integration into the GATS system. This is set out in Article XXV:2

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[14] Asoke Mukerji, "Developing Countries and the WTO: Issues of Implementation", 34(6) *JWT* (2000), p. 33 at 59.

[15] Boutheina Guermazi, "International Accounting Rates, Developing Countries and the WTO: the Dilemma and a Possible Solution", *International Journal of Communication Law and Policy*, Issue 3, summer 1999, p. 20.

[16] *Mexico-Telecommunications*, Panel Report, WT/DS204/R, adopted 1 June 2004, para. 7.388. See also Chapter 4.

and Section 6 of the Annex on Telecommunications. In the Annex, WTO Members recognize the importance of efficient and advanced telecommunications infrastructure to the expansion of trade in services. The provision therefore requires Members to make available to developing countries information on telecommunications services and developments in telecommunications and information technology to help them strengthen their domestic telecommunications sector. Members must also encourage and support telecommunications cooperation among developing countries at the international, regional and sub-regional levels.[17]

To carry out this mandate of providing technical assistance, the WTO Secretariat provides a variety of training courses especially for developing countries to help them strengthen their knowledge and understanding of the WTO rules and its Agreements. For example, the WTO has held specialized courses on trade in services as well as dispute settlement. Most recently, the WTO and the ITU organized jointly a training workshop for telecoms regulators from member countries.[18] The workshop provided the participants from regulatory authorities with the opportunity to learn more about the WTO rules that affect their domestic systems and participate in practical, interactive exercises on how to apply these rules.

2. Developing Countries and the Liberalization of Trade in Services

Developing country Members of the WTO are bound by the rules of trade in services contained in the GATS as part of the 'package-deal' every WTO Member accepted at the end of the Uruguay Round. They have not,

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[17] Section 6(b) Annex on Telecommunications.

[18] See WTO News, 1 December 2004 at http://www.wto.org/engligh/news_e/news04_e/tpc_1dec04_e.htm .

however, embraced the WTO multilateral rules on trade in services as enthusiastically as the developed countries have. There are a number of reasons why developing country Members find it difficult to have confidence in the GATS and the multilateral system of liberalizing trade in services.

First, there is the issue of data and assessing the impact of trade in services. More specifically, there seems to be a lack of concrete evidence that proves that liberalization of trade in services brings substantial economic benefits to developing countries. Until there is substantial evidence that liberalization of trade in services brings noticeable benefits to developing countries, they will remain skeptical of the world trade system in services and make limited WTO commitments on sector-specific trade in services. They believe they have good reason to be suspicious. Developing countries have not received concessions of any meaningful economic value under the movement of natural persons mode of supply. As a result, most developing countries have a deficit in trade in services except in the areas of tourism and travel, and worker remittances.[19]

In addition, developing countries, who make up two-thirds of WTO membership, only accounted for about 21 per cent of world exports of commercial services in 1997, while Canada and the US alone made up 20 per cent and Western Europe accounted for 45 per cent.[20] The concentration of trade in services is thus among the advanced economies, with most of the trade taking place between North America and Western

[19] WTO, CTS, Special Session, "Communication from Argentina, Brazil, Cuba, the Dominican Republic, Haiti, India, Kenya, Pakistan, Peru, Uganda, Venezuela and Zimbabwe: Assessment of Trade in Services", S/CSS/W/114, 9 October 2001, para. 7.
[20] WTO, *High Level Symposium 1999*, p.11. In 2001, developing countries' share of world export in commercial services was just over 23 per cent. WTO, *International Trade Statistics 2002*, p. 14.

Europe, thereby making developing countries "traders at the margin".[21] Developing country providers, who are mostly small enterprises, face competition from large multinationals that have massive financial strength, access to the latest technology, worldwide networks and sophisticated IT infrastructures. It is therefore difficult, if not impossible, for developing countries to "catch up" under such unequal circumstances of competition.[22]

Second, provisions in the GATS giving special treatment to developing countries, in particular Article IV, are not being implemented by developed country Members.[23] Article IV of GATS is intended to assist developing countries through increasing their participation in world trade through negotiated specific commitments relating to, among others, "the liberalization of market access in sectors and modes of supply of export interest to them."[24] Developed country Members seem to have ignored this in practice by continuing to restrict market access through the fourth mode of supply (movement of natural persons) – the mode where most developing countries, including India, have a comparative advantage due to their abundant supply of relatively cheap labour.[25]

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21 Neela Mukherjee, "GATS and the Millennium Round of Multilateral Negotiations: Selected Issues from the Perspective of Developing Countries", 33(4) *JWT* (1999), p. 87 at 92.
22 WTO, CTS, Special Session, S/CSS/W/114, para. 15.
23 The only real special support given to developing countries are in the form of technical assistance – for example, training government officials from developing countries through workshops and seminars, and the setting up of the Advisory Centre on WTO Law in 2000. But what developing countries need and desire are specific commitments from the developed country Members in services sectors, especially in those where they are strong in, and in particular for those of mode 4 delivery.
24 Article IV:1(b) of the GATS.
25 Furthermore, new items for potential inclusion into the WTO system concerning investment, competition policy and labour standards have been introduced by developed countries before the GATS is even fully implemented. These new issues, driven forward mainly by the EU, have pushed the initial Uruguay Round commitments into the background, and thus making it difficult for the developing countries to keep pace with such rapid developments. A range of developing countries broadly supports the view, voiced by India, that the issue of fair implementation of special and differential treatment should be tackled first (see Mukherjee, 33(4) *JWT* (1999), p. 98). In May 2004, the EU agreed to drop the "new issues" from the Doha Development Agenda (DDA).

Third, developing countries do not have an advanced regulatory environment similar to that of developed countries. The architects of the GATS were from developed countries, and they used the economic and legal models that governed the regulatory system in their countries to draw up the GATS. The systems of the developed world are alien to developing countries. Many developing countries have signed up to complex agreements like the GATS without understanding their full implications.[26] This has left them considerably handicapped in applying the technical agreements to their policy framework.

The design of an appropriate regulatory system to suit their service industries and comply with their WTO commitments is one of the many challenges facing developing countries. Although developing countries are skeptical of the benefits to them of opening up their markets to trade in services, they do recognize the significance of the growth in the internationalization of services that has come about through rapid technological change in information technology and telecommunications. There are opportunities to be gained by developing countries from the growth of trade in services but for this to happen, they must adapt their regulatory environments. An appropriate regulatory system is crucial to the liberalization of trade in services.

As a consequence of the above concerns, developing countries are taking an active role in the current GATS negotiations which commenced in 2000.[27] They are demanding that the special treatment provisions in the GATS with regard to developing countries be implemented by developed countries, and that the important GATS concepts of flexibility

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[26] N. Mukherjee (1999), p. 97.
[27] Hereinafter GATS 2000 negotiations.

and autonomous liberalization are put into practice for the benefit of developing countries. Developing country Members are determined that this round of negotiations should focus on the interests and demands of developing countries and that true benefits to them are achieved. They are intent on remedying the Uruguay Round which they alleged "had neither achieved a balance of rights and obligations nor promoted the interests of all participants, particularly those of developing countries".[28]

II. GATS 2000 Negotiations and Developing Countries

The GATS 2000 negotiations commenced as part of the WTO's mandate on progressive liberalization. This obligation is contained in GATS Article XIX. The services negotiations must aim to provide effective market access and thereby reduce or eliminate the adverse effects on trade in services caused by restrictive measures. The services negotiations is now incorporated into the Doha agenda, adopted in November 2001 as part of the WTO's new round of multilateral negotiations (the Doha Round).[29]

GATS Article XIX provides opportunities for developing countries to increase their participation and standing in world trade. As seen above in Section I.1, the provisions granting special treatment are of particular importance to developing countries. Article XIX:2 provides

[28] WTO, CTS (Special Session), *Report of the Meeting held on 5 and 6 December 2000*, S/CSS/M/7, 2 March 2001, para. 46.

[29] The progress and timetable of the services negotiations are as follows: the negotiating guidelines and procedures of the services negotiations were adopted on 28 March 2001; initial offers of market access were to be tabled by 31 March 2003; stock-taking took place at the WTO Fifth Ministerial Conference in Cancun, Mexico in September 2003; and the negotiations were due to complete on 1 January 2005 as part of a single package of the WTO Doha Round. Due to the stalling of the Doha Round since Cancun, the negotiations have been extended. The new timetable includes revised services offers to be tabled by May 2005, and the Doha Round is extended at least until the Sixth Ministerial Meeting in Hong Kong in December 2005. See WTO, *Doha Work Programme*, WT/L/579, 2 August 2004.

the flexibility developing countries need with regard to liberalization by allowing them to open fewer sectors and liberalize fewer types of transactions, while progressively extending market access in line with their level of developments. In Article XIX:3, the provision on autonomous liberalization is significant to developing countries.

1. *Autonomous Liberalization*

Article XIX:3 of the GATS states:

> Negotiating guidelines shall establish modalities for the treatment of liberalization undertaken autonomously by Members since previous negotiations.

Autonomous liberalization first became a negotiating issue during the Uruguay Round and was discussed extensively in the negotiating group on market access. The concept of autonomous liberalization has always been difficult to tackle due to its unlimited flexibility. It is not defined in the GATS. The essential problem was "whether autonomous liberalization was trade liberalization undertaken and bound in an autonomous manner, i.e. outside the context of a negotiation, or trade liberalization undertaken unilaterally but not bound."[30] The WTO Secretariat has suggested that autonomous liberalization most likely means "liberalization undertaken by individual Members unilaterally, outside a negotiating context."[31]

Autonomous liberalization is of the "utmost importance" to developing countries.[32] Many developing countries, motivated mainly by national interest, have undertaken extensive measures of autonomous

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[30] WTO, CTS (Special Session), *Report of the Meeting held on 1 December 2000 on the Treatment of Autonomous Liberalization*, S/CSS/M/6, 22 January 2001, para. 4.
[31] WTO, CTS (Special Session), *Report of the Meeting held on 5 and 6 June 2002*, 10 July 2002, TN/S/M/2, para. 27.
[32] WTO, CTS (Special Session), *Report of the Meeting held on 14 to 17 May 2001*, S/CSS/M/9, 22 June 2001, para. 7.

liberalization in the different services sectors. Developing countries therefore sought credit and recognition for these liberalization measures undertaken autonomously for the purpose of strengthening their negotiating positions in the WTO. The issue was whether the measures undertaken autonomously had to be bound before credit was given. Developing countries argued that this issue was important to them and that credit should not depend on autonomous measures being bound. This was especially more so when a developing country was undergoing structural and regulatory reforms in the services sector because there is more flexibility to adjust or modify an unbound measure.[33]

India was among the developing country Members active in highlighting the importance of autonomous liberalization. India, like most other developing country Members, argued that the modalities for autonomous liberalization should not result in simply expecting countries to bind such liberalization. Autonomous measures should be clearly distinguished from international commitments in the WTO. India argued that if Members had to bind those measures they had autonomously liberalized in order to obtain credit, they would have no incentive to carry out further autonomous liberalization in the future.[34] Furthermore, autonomous liberalization should be encouraged and more favourable treatment should be accorded to countries having undertaken such liberalization.[35]

The encouragement of autonomous liberalization could be achieved through giving credit and recognition to it, but this should be done

[33] WTO, CTS, *Report of Meeting 1 December 2000*, S/CSS/M/6, para. 24; and *ibid.*
[34] WTO, CTS, Report of Meeting 5 and 6 December 2000, S/CSS/M/7, para. 7.
[35] WTO, CTS, S/CSS/M/9, para. 10.

through multilaterally agreed criteria and should not be left completely to bilateral bargaining.[36] For the purposes of transparency, it was important to address autonomous liberalization in a multilateral forum and assess the actual level of liberalization in services sectors undertaken by Members.[37]

Negotiators in the WTO finally agreed on the modalities for the treatment of autonomous liberalization in March 2003.[38] The modalities define an "autonomous liberalization measure" as a measure,

(a) subject to scheduling under Part III of the GATS, and/or leading to the termination of an MFN exemption,
(b) compatible with the MFN principle,
(c) undertaken by the liberalizing Member unilaterally,[39] since previous negotiations, in accordance with Article XIX of the GATS, and
(d) applicable to any or all service sectors.[40]

The modalities provide a illustrative list of criteria which a Member may use to assess the value of an autonomous liberalization measure. The same criteria may be used to assess the value of credits. The modalities do not stipulate that an autonomously liberalized measure must be bound before credit could be given. However, "whether the measure in question has already been scheduled and if not, whether the liberalizing Member is willing to do so"[41] can be taken into account when assessing both the value of the specific autonomous measure and the corresponding credit.[42]

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36 WTO, CTS, *Report of Meeting 1 December 2000*, S/CSS/M/6, para. 11.
37 *Ibid.*
38 WTO, CTS Special Session, "Modalities for the Treatment of Autonomous Liberalization", adopted on 6 March 2003, TN/S/6, 10 March 2003. (Hereinafter Modalities).
39 It is understood that liberalization measures undertaken as part of economic reform programmes, including those under the auspices of the IMF and the World Bank, should be considered as "autonomous liberalization measures" for the purposes of these modalities, in so far as they meet the criteria set out in this paragraph.
40 Modalities, para. 3.
41 Modalities, para. 4(i).
42 Modalities, paras. 4(i) and 6.

The issue of autonomous liberalization is relevant to telecommunications liberalization. India, like other developing countries, has undertaken significant measures which autonomously liberalize its telecommunications sector. This is discussed below.

2. Developing Countries and Telecommunications Liberalization Generally

As discussed in Chapter 4, the significance of telecommunications services as a service economy in its own right and as an underlying mode for the delivery of other services renders this economic sector crucial to the economic growth and development of any country. Telecommunications services is an area of critical relevance for countries interested in pursuing outward-oriented strategies of development.[43] The telecommunications sector is one of the key infrastructures of a country and it is essential to carry out other economic activities. In the age of rapid development in technologies and the global nature of modern trade, in particular as a result of the services revolution, an effective, advanced and competitive telecommunications system is requisite to a country wanting and needing to develop and compete globally.

Many developing countries, however, are hard pressed to meet the demand for even basic telecommunications services, and investment in networks for value-added services may be considered an unaffordable luxury. Some developing country governments are reluctant to liberalize for several reasons. One of these is the fear that the introduction of competition would result in enormous job losses. However, according to a

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[43] C. Braga, "The Impact of the Internationalization of Services on Developing Countries", March 1996. Available at http://www.worldbank.org.

comparative analysis of twenty-six countries in Asia and Latin America conducted by the ITU, the evidence seems to suggest that this is not the case. The analysis showed that during 1990-1994 employment in markets with varying degrees of competition increased by 20.73 per cent, while in monopoly markets employment grew by only 3.13 per cent.[44]

Another reason for developing countries' resistance to telecommunications liberalization is the fear of some governments that competition will put universal service at risk. In practice, however, most of the available data point to an increase in network penetration and service availability with competition.[45] This seems to be the case in India. When India's telecommunications system was run by the state monopoly provider, the Department of Telecommunications, teledensity[46] in 1994 was a mere 0.8.[47] After introduction of some competition in 1994 and the opening up of all telecommunications services to competition in 2002, India's teledensity has increased to 4 by 2002,[48] and 8.37 by end of 2004.[49]

In addition, competition in cellular services, which has been introduced more widely and for longer than competition in wireline services in developing countries, clearly has led to much greater network penetration than monopolies.[50] Again, this is the experience in India. Ever since the Indian government allowed private sector competition in

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[44] Ben Petrazzini, "Competition in Telecoms – Implications for Universal Service and Employment", *Public Policy for the Private Sector*, Note No. 96, October 1996.
[45] B. Petrazzini (1996).
[46] The number of main telephone lines or connections per one hundred persons.
[47] Government of India, DoT, *The National Telecom Policy 1994.* (NTP 1994).
[48] WTO, TPRB, *Trade Policy Review, India: Report by the Secretariat,* WT/TPR/S/100, 22 May 2002, p. 130, para. 100.
[49] This figure includes mobile phone connections. *The Economic Times Online,* "Tele-density moves up", 2 January 2005.
[50] C. Fink, A. Mattoo and R. Rathindran, "An Assessment of Telecommunications Reform in Developing Countries", World Bank Policy Research Working Paper, WPS2909, October 2002, p. 5.

mobile services in the early 1990s, private operators have made mobile services the fastest growing sector in India.[51] There were 6.7 million cellular subscribers by the beginning of May 2002,[52] which increased to 37.8 million by the end of June 2004.[53] Mobile phones grew by 160% from March 2003 to March 2004 while fixed lines grew by only 3%.[54] Connectivity in rural areas of India has also been enhanced by a competitive cellular sector.[55]

A third reason why some developing countries have restricted telecommunications liberalization is the need to protect the cultural identity of the country. Developing country governments, including the cultural ministry of the Indian government, fear that foreign companies will end up taking control of the country's telecommunications industry and force upon their citizens imported content unacceptable to their culture or worse still marginalizing their cultural identity.[56]

A further concern is national security. This is often cited as an argument against opening up the domestic telecommunications market. This problem, however, can be addressed through legislation restricting liberalization of telecommunications services serving government bodies dealing with national security. Every other telecoms sectors can then be safely liberalized.

Despite the concerns developing countries have for liberalization of the telecommunications sector, over the past few years many have come to

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[51] *The Economist*, "Indian Telecoms: Connecting Competition", 4 April 2002.
[52] Over 28,000 additional customers were signed up in the month of April alone. *The Hindu, Business Line*, Internet Edition, 10 May 2002, at http://www.blonnet.com/2002/05/10/stories/2002051000610700.htm.
[53] TRAI, The Indian Telecom Services Performance Indicators July-September 2004 (December 2004), p. 12. (Hereinafter *Indicators July-September 2004*).
[54] Government of India, DoT, *Annual Report 2003-2004*, p. II. (Hereinafter *Annual Report 2003-2004*).
[55] *The Economist*, "Mobile Phones in India: Another Kind of Net Work", 1 March 2001.
[56] *The Economist*, "When India wires up," 20 July 2000.

realize that a modern, high-quality telecommunication services infrastructure is essential to the country's economy. As a result, more than ninety developing countries opened their telecommunications sector to private participation between 1990 and 1998.[57] Driving this liberalization of state-owned networks has been the desire to expand and improve services as national governments were unable to finance the necessary infrastructure improvements to their respective telecommunications system.[58] Furthermore, the belief that liberalization in the telecommunications sector was essential to their development was reflected by the participation of developing countries in the negotiations on basic telecommunications that took place after the Uruguay Round from 1994-1997.[59]

The WTO telecommunications commitments made by developing countries in the WTO are of varying extent. As we will see later, India was among those developing country Members who made rather limited commitments. Nonetheless, most developing countries, including India, scheduled higher level of commitments regarding commercial presence than on any other mode of supply.[60] The considerable challenge for many developing countries since the signing of the ABT has been the practical implementation of the commitments. Developing countries are once again negotiating on telecommunications services in the WTO as part of the WTO's mandate on progressive liberalization. In this Round, they have to deal with developed countries' insistence that telecommunications be

[57] A. Izaguirre, "Private Participation in Telecommunications – Recent Trends", *Public Policy for the Private Sector,* Note No. 204, December 1999.
[58] E. Leahy and M. O'Brien, "Prospering from the International Telecommunications Revolution: A Party by 'Invitation Only'", *International Journal of Communications Law and Policy,* Issue 4, Winter 1999/2000, p. 7.
[59] Over 40 developing countries took part in the extended negotiations on basic telecommunications. WTO website: http://www.wto.org.
[60] WTO, *High Level Symposium 1999,* p. 22.

further liberalized through full adherence to the Reference Paper and making greater commitments towards market access. Some developing countries, however, have yet to implement fully the commitments made in the previous negotiations.

3. *GATS 2000 Negotiations and Telecommunications*

The discussions that have taken place on telecommunications liberalization in the GATS 2000 negotiations have so far been pursued more actively by developed country Members, with the US taking its participation further by proposing certain issues beyond liberalization. In its proposal at the meeting of the Special Session of the Council for Trade in Services held in May 2001, the US suggested that full privatization of operations and telecommunications networks was an important first step in the liberalization of telecommunications.[61] The US argued for privatization because historically, the US telecommunications industry has always been operated by private companies.[62] US companies thus have a comparative advantage in privately-run telecommunications markets. Moreover, a privatized telecoms sector enables the US to apply its anti-trust laws through the WTO system and affect the domestic policies of its trading partners. In this way, the US can increase its telecommunications trade. Privatization also means less government involvement which could mean greater access to markets for competitors.

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[61] WTO, CTS (Special Session), "Communication from the United States: Market Access in Telecommunications and Complementary Services: the WTO's Role in Accelerating the Development of a Globally Networked Economy", S/CSS/W/30, 18 December 2000. See also WTO, CTS, Report of Meeting 14-17 May 2001, S/CSS/M/9, paras. 180-195; and WTO, CTS (Special Session), *Report of the Meeting held on 9 to 12 July 2001*, S/CSS/M/10, 21 September 2001, para. 183.
[62] See Chapter 2.

Even though the US model for a privatized telecommunications sector involves an independent regulator overseeing the industry's operations, such a regulator provides greater transparency and impartiality than state-run telecoms operators.

The US call for full privatization attracted strong reaction from developing countries who stressed that privatization was a domestic matter and should not be made a subject of negotiations under the GATS.[63] Even other developed countries like Japan and the EC did not share the US view for prioritizing privatization through the multilateral arena.[64] They pointed out that what was more important with regard to telecommunications liberalization was the promotion of competition through an independent regulator and a pro-competitive regulatory framework.[65]

Other active participants in the GATS 2000 negotiations included 'richer' developing countries like the Republic of Korea, Singapore and Hong Kong who supported further liberalization of the telecommunications sector through making further commitments and adopting and adhering to the Reference Paper in full.[66] Other developing countries - Turkey, Brazil, Argentina, Israel, and Venezuela - who have experienced great economic benefits through the liberalization of their telecommunications sectors, have also expressed full support for the liberalization of telecoms services and the opening up of markets through market access and national treatment commitments.[67] Meanwhile Mexico, which claimed that all its telecommunications sub-sectors have been opened to competition (except

[63] WTO, CTS, *Report of Meeting 14-17 May 2001*, S/CSS/M/9, paras. 180-195.
[64] *Ibid.*, paras. 189 and 191.
[65] *Ibid.* See also WTO, CTS, *Report of Meeting 9-12 July 2001*, S/CSS/M/10, para. 189.
[66] WTO, CTS, *Report of Meeting 14-17 May 2001*, S/CSS/M/9, paras. 190, 192 and 193.
[67] WTO, CTS, *Report of Meeting 9-12 July 2001*, S/CSS/M/10, paras. 186, 193, 194, 200, 201.

in satellite services) and that it had adopted the Reference Paper, stressed that liberalization for developing countries should be gradual and that the negotiations should also take into consideration the results of the assessment of trade in services under GATS Article XIX.[68]

Saint Lucia, a smaller developing country participant, stressed that it was incorrect to state in such a sweeping manner (as the US had done)[69] that restricted access would only hurt developing countries. Saint Lucia stated that the "one-size-fits-all" approach was inappropriate,[70] reiterating that,

> The *flexibility* of the GATS approach must not be undermined by the liberalization process and that developing countries should be able to make commitments on the basis of their level of development and the size of their economy.[71]

Another active developing country Member who expressed the need to take account of the special and differential needs of developing economies was Cuba whose proposal on telecommunications was intended to promote measures to facilitate the growing participation of developing countries in telecommunications trade, by having regard for their economic situation and development, trade and financial needs.[72] Cuba pointed out that

> [A]lthough private sector participation in telecommunications sector financing in certain developing countries in the 1990s had reflected the increasing coverage of telephony in these countries, the technological divide which separated them from the developed world had not been bridged, adequate access to information and communication technologies had not been provided, particularly in rural and remote areas, and this continued to present a barrier to the potential of these countries to participate in world trade on an equal footing [...] this demonstrated why developing countries needed satisfactory regulation of the sector in order to ensure harmonious national development [...] the right of Members to regulate

[68] *Ibid.*, para. 182.
[69] *Ibid.*, para. 183.
[70] *Ibid.*, para. 204.
[71] *Ibid.*, para. 204. Emphasis added.
[72] WTO, CTS (Special Session), "Communication from Cuba: Negotiating Proposal on Telecommunications Services", TN/S/W/2, 30 May 2002.

and introduce new regulations was reaffirmed by Ministers in paragraph 7 of the Doha Declaration.[73]

Cuba recognized the importance of global telecommunications trade to the economic and social development of developing countries and proposed that the negotiations take this into account by applying Article XIX:2 of the GATS to the letter.[74]

In the current negotiations, India has so far not made any statements of substance nor submitted proposals on this service sector. India's main focus in the Doha round of services negotiations is the movement of natural persons for which India has submitted a proposal[75] and to which India has devoted itself to making sure that this important issue receives due recognition in the debates and discussions. Another important service sector to India is the computer and related services sector as computer software services have recently and rapidly grown in India into a large industry generating enormous revenues. India has also submitted a proposal in this service sector.[76] In its conditional offer submitted to the WTO in December 2003, India has greatly committed to liberalize the computer services sector.[77] Its offers to liberalize telecommunications services, however, remain very limited.[78]

The next section examines India's telecommunications sector and the extent of its liberalization.

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[73] WTO, CTS (Special Session), *Report of the Meeting held on 5 and 6 June 2002*, TN/S/M/2, 10 July 2002, para. 100.
[74] *Ibid.*, paragraph 101.
[75] WTO, CTS (Special Session), "Communication from India: Proposed Liberalization of Movement of Professionals under General Agreement on Trade in Services (GATS)", S/CSS/W/12, 24 November 2000, and 11 December 2000, S/CSS/W/12/Corr.1.
[76] WTO, CTS (Special Session), "Communication from India: Negotiating Proposal on Computer and Related Services", S/CSS/W/141, 22 March 2002.
[77] WTO, CTS, "India: Conditional Initial Offer", TN/O/IND, 12 January 2004. See Appendix IX.
[78] *Ibid.*

III. Background to India's Telecommunications Industry

From the time India gained independence from British rule on 15 August 1947 up to 1991, the Indian economy was based on what has become known as "Nehruvian socialism".[79] Central planning and strong state control of the most influential sectors of the economy through large-scale enterprises were India's economic policies. In the telecommunications sector, for instance, all foreign telecommunications companies were nationalized in 1947 to form the Posts, Telephone and Telegraph (PTT), a monopoly run by India's Ministry of Communications. Nehru thought that competition was bad and he had "contempt for the price mechanism".[80] The result of this policy, together with heavy protectionist measures, was slow economic growth rate - falling considerably behind those of South East Asian countries - and severe trade imbalances and double-digit inflation. Indian policies eventually required the IMF to step in with an emergency help of a US $2.3 billion loan.

The intervention of the IMF resulted in the most sweeping and dramatic economic reforms in India's history when P.V. Narasimha Rao became Prime Minister in 1991. The Indian government under Rao had as its objective the integration of the Indian economy more closely with the world economy. The radical economic reforms of the Rao government, through the New Industrial Policy 1991, saw a dramatic increase in India's economic growth to 7.2% in 1994-1995, with an average growth rate

[79] Lara Srivastava and Sidharth Sinha, *Fixed-Mobile Interconnection: the Case of India*, 2000, p. 7.
[80] Daniel Yergin and Joseph Stanislaw, *The Commanding Heights: The Battle Between Government and the Marketplace that is Remaking the Modern World* (1998), as cited in A. Menon, "India: Adopting a Pro-Competitive Policy for Telecommunications", 12 May 1999, p. 20.

during the years 1993-1996 at 7%.[81] India's external reforms focused on trade liberalization and export promotion, culminating in India's active participation in the Uruguay Round. As regards internal reforms, India began to move towards privatization of state-owned enterprises from 1991.

The telecommunications sector was no exception. Liberalization of India's telecommunications sector began in the early 1990s with the introduction of competition, in 1992, from the private operators in value-added telecommunications services and cellular mobile telephone. In the following years, the Indian government adopted two major policies, one in 1994 and the other in 1999, to reform the telecommunications industry. Today, the Indian telecommunications industry is one of the fastest growing in the world, with a growth rate averaging 22 per cent per annum in recent years.[82] Prior to the 1990s, however, India's government policies, like those of other countries pre-competition, were adopted on the firm belief that the telecommunications industry was a natural monopoly and that to avoid wasteful duplication, state telephone companies should maintain their legal monopoly.

1. *The Regulatory Framework during the Monopoly Years*

Prior to the reforms, India's telecommunications legislation consisted of the India Telegraph Act 1885 and the Indian Wireless Act 1933. The India Telegraph Act gave the Indian government the exclusive privilege of

[81] WTO, Press release, 1 April 1998, PRESS/TPRB/71.
[82] Government of India, DOT, *Annual Report 2001-2002*, p. 5. (Hereinafter *Annual Report 2001-2002*).

providing basic telecommunications services, and this provided the legal basis for the government's monopoly in telecommunications. Until 1985, India's telecommunications services were provided by the PTT state monopoly run by the government's Ministry of Communications. In 1985, Rajiv Gandhi ordered the bifurcation of the Department of Posts and Telegraph into the Department of Posts and a separate Department of Telecommunications (DoT). Until recently, the PTT and after 1985, the DoT, was the sole provider of all telecommunications services: local, domestic long-distance and international services. The DoT was also the regulator and policy-maker of India's telecommunications sector.

The India Telegraph Act 1885 also allowed the Indian government to authorize a licensee to provide basic telecommunications services under specified conditions. As a monopoly provider, the DoT did not issue any licenses to any other operators but when competition was introduced into the basic telecommunications sector in 2000 the DoT became responsible for the grant of licenses to private sector operators.

2. *Current Structure of India's Telecommunications Sector*

The DoT was the state operator of telecommunications services as well as the licensor until October 1999. The role of regulator, however, now lies in a new independent body called the Telecom Regulatory Authority of India (TRAI), which was established in 1997. The TRAI is discussed in Section VI.2 below.

In October 1999, however, the DoT was further divided into the Department of Telecom Services (DTS) and the Department of Telecommunications (DoT), and this somewhat separated the activities of the operator and the licensor. The DTS is responsible for providing telecommunications services and the DoT retains its mandate as policy-maker and licensor. This separation, however, was largely artificial. It has been observed that despite the separation, the two departments are effectively one and the same organization. In fact, many DoT/DTS officials work for both organizations simultaneously.[83]

Further changes were made when the DTS was "corporatized"[84] in October 2000 and became Bharat Sanchar Nigam Limited (BSNL). BSNL is wholly government owned and is today the largest public sector undertaking in India.[85] It is the dominant provider and operator of telecommunications services in India, except for the metro regions of New Delhi and Mumbai. BSNL, inheriting the business of the monopoly PTT and later the DoT, provides the largest telecom network in the country. It runs telecommunications services in 24 Telecom Circles and 2 Metro Districts, provides cellular services[86] and it is also an Internet Service Provider (ISP).

The metro areas of Mumbai and New Delhi are serviced by the government majority owned (56.25%) dominant operator, Mahanagar Telephone Nigam Limited (MTNL). MTNL started operating in 1987 in order to supplement the insufficient efforts of the DoT in providing telecommunications services.[87] MTNL launched mobile cellular services

[83] L. Srivastava and S. Sinha (2000), p. 15.
[84] Corporatization involves the re-structuring of a government enterprise into organizational and management forms similar to a private company. Coporatization is not privatization although it has been used, for example in New Zealand, as a prelude to privatization.
[85] *Annual Report 2003-2004*, p. 39.
[86] BSNL launched its cellular services on 19 October 2002, and became the first operator to provide cellular services nationwide, except in Delhi and Mumbai where MTNL operates. See BSNL News, 20 October 2002, at http://www.bsnl.in/bsnlnews.asp?intNewsId=3189&strNewsMore=more.
[87] When MTNL was formed on 1 April 1986, it was wholly owned by the government.

using GSM[88] technology in Delhi in January 2001 and in Mumbai in February 2001.[89] It has also become an ISP from February 1999.

In May 2004, the Indian government ruled out privatization of BSNL and MTNL.[90] Instead, the plan introduced in September 2002, to the surprise of the industry, to merge the two state-owned operators is set to go ahead and – after having been stalled for a year – is scheduled to take place towards the end of 2005.[91] The combined BSNL-MTNL is estimated to control over 95 per cent of the fixed line market and have nearly 40 million wireless phone customers.[92] The union could, according to some analysts, catapult the merged entity into the top-10 integrated telecommunications operator in the world.[93] Some analysts, however, warn that the merger is not likely to solve any of the existing problems faced by the two operators: namely, red tape, political interference and high employee costs (elements which cause inefficiency).[94] They stress that the savings expected to occur from the merger, contrary to what DoT officials insists, would be minimal.[95]

As for international telecommunications services, Videsh Sanchar Nigam Limited (VSNL) was set up in 1986 as the sole operator and provider. The international services provided and controlled by VSNL

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[88] Global Standard for Mobile Telephony.

[89] Prior to this, MTNL started its mobile services in Delhi in October 1999 and in Mumbai in August 2000, using CDMA (Code Division Multiple Access) technology.

[90] *The Hindu*, "They are off disinvestment list", 27 May 2004, at http://www.thehindu.com/2004/05/27/stories/2004052704311200.htm.

[91] *The Financial Express*, "BSNL-MTNL merger process may take 10-12 months", 18 November 2004, at http://www.financialexpress.com/fe_full_story.php?content_id=74428.

[92] *Sify*, "BSNL-MTNL merger within 6 months", 17 November 2004, at http://sify.com/finance/fullstory.php?id=13612320.

[93] Integrated telecommunications companies provide all types of telecoms services, as opposed to those providing only mobile or fixed-line services for example. *The Economic Times*, "Tale of 2 Titans: When BSNL merges with MTNL", 22 November 2004.

[94] *The Economic Times*, "Government dogged by hurdles in MTNL-BSNL merger plan", 11 January 2005.

[95] *Ibid.* The government-appointed consultants of ICICI Securities and ABN Rothschild are expected to give their combined report on the proposed merger by March 2005.

include 1) basic service such as telephony, telegraph, telex 2) specialized services, which cover a broad range of data services and 3) value added services such as Internet connectivity. In August 1995, VSNL introduced Internet services on a commercial scale. Basic services, however, contributed more than 85% of VSNL's revenue.[96]

The VSNL monopoly ceased officially on 31 March 2002, opening the market of international telecommunications to competition on 1 April 2002. Today, there are four operators, including the incumbent VSNL, providing international long-distance (ILD) services in India.[97] Meanwhile, BSNL has been given a licence in early 2003 to supply ILD services but has not yet started providing them. In addition, MTNL was issued with a Letter of Intent (LOI) in March 2004.

In mid-February 2002, the Indian government sold 25% of its 52.97% stake in VSNL to the Tata Group, a strategic partner. Today, the government retains a share of 26% in VSNL while 45% is owned by the Tata Group.

IV. Reform of the Telecommunications Industry

The Rao government recognized that telecommunications services of world class quality were necessary for the success of the New Industrial Policy of 1991. The government, as part of India's economic reform, thus set about

[96] *Annual Report 2001-2002*, p. 80.

[97] They are Bharti Infotel which started providing ILD services on 19 July 2002; Data Access (India) which started its services on 23 July 2002; and Reliance Infocomm which commenced its services on 29 March 2003.

giving the highest priority to the development of the telecommunications sector.

1. *National Telecom Policy 1994*

As seen above, the limited liberalization of India's telecommunications sector began in value-added services and mobile services. Value-added services were opened to the private sector in July 1992,[98] and private sector companies were invited by the DoT to make competitive bids for non-exclusive digital mobile licenses for the four metropolitan cities of Mumbai, Delhi, Calcutta and Chennai. In basic telecommunications services, the DoT remained the sole provider. Although the DoT was successful in making improvements to the telecommunications infrastructure, the DoT did not succeed in reducing the waiting list for demands for telephone lines.

The Indian government therefore initiated the National Telecom Policy in 1994 (NTP 1994) to meet these rapidly growing demands. The NTP 1994 was India's first major move towards liberalizing the telecommunications sector. The NTP 1994 introduced the license-bidding process to end the DoT's country-wide monopoly on basic services. This resulted in India being divided up into 21 "telecom service circles" – each categorized as either A, B or C according to its importance.[99] Category A includes the heaviest areas such as Delhi. One private operator was

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[98] These services included: electronic mail, voice mail, data services, audio text services, video conferencing, radio paging and cellular mobile telephone. The National Telecom Policy 1994, Section 8.

[99] The Indian government divides the country into "telecom service circles/areas" for the purpose of issuing licenses to telecom service providers, whether for cellular or fixed telephony or cable providers. The circles are usually co-terminus with state boundaries. Today, there are 28 circles. Cf. US's LATA system after the break-up of AT&T; See Chapter 2, Section IV.3.

allowed a license for each telecom circle. Any number of Indian or foreign companies can combine and constitute a bidder company, but the maximum foreign equity permitted is 49%.

In addition to the plan for private sector entry into basic telecoms, the NTP 1994 set out a number of objectives that would develop the Indian telecommunications industry to match the growing needs of the Indian economy. The ultimate objective of the NTP 1994 was to achieve world class quality in telecommunications and to make available a whole range of services.[100] However, some major objectives of the NTP 1994 failed to be achieved: namely, the availability of telephone on demand by 1997, telecommunications coverage of all villages by 1997 and effective penetration of basic telecommunications market by private companies to compete with the DoT.

The NTP 1994 failed to achieve a world class telecommunications industry as planned due to many implementation hurdles and limited private services in implementing and providing new services. These hurdles included high license fees which resulted in high costs in providing the services.[101] In addition, TRAI's recommendations for granting licenses were blocked consistently by the DoT. Consequently, private sector entry was slower than anticipated by the NTP 1994.

Nonetheless, the NTP 1994 did achieve a number of its objectives. The government met the target of providing 1 public call offices (PCO) per 500 urban population (it actually achieved an urban PCO penetration of 1 PCO per 522).[102] As for the increase in telephone lines, the government

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[100] Sowri Rajan Komandur, "The Telecom Policy of India: Globalization and Global Information Society" (2000), p. 2. Available at http://www.its2000.org.ar/conference/komandur.pdf.
[101] *Ibid.*, p. 3.
[102] New Telecom Policy 1999 (NTP 1999), Section 1.2.

managed, during the NTP 1994, to exceed the Eighth Plan[103] target of 7.5 million lines by 1.23 million.[104] However, it did not meet its NTP 1994 plan of releasing 10 million lines necessary to provide telephone on demand by 1997. The government was thus prompted into reconsidering the targets of the NTP 1994 and setting new objectives in the New Telecom Policy 1999 (NTP 1999).

2. *The New Telecom Policy 1999*

The NTP 1999, announced by the government in March 1999, became effective from April 1999. New objectives were set for the achievement of a comprehensive and forward looking telecommunications policy. These objectives were to ensure the following:

i) the availability of affordable and effective communications for citizens;

ii) the provision of a balance between the provision of universal service and the provision of high-level services capable of meeting the needs of India's economy;

iii) the encouragement of the development of telecommunications facilities in remote, hilly and tribal areas of the country;

iv) the creation of a modern and efficient telecommunications infrastructure taking into account the convergence of IT, media, telecom and consumer electronics;

[103] Since 1950 the Indian government has initiated five-year plans in telecommunications infrastructure investment and development. The Eighth Plan was from 1992-1997.
[104] NTP 1999, Section 1.2.

v) the transformation of the telecommunications industry, within a time limit, into a more competitive environment with equal opportunities for all market players;

vi) efficiency and transparency in spectrum management;

vii) protection of defence and security interests of the country; and

viii) that Indian telecommunications companies become truly global players.[105]

To achieve these new objectives, specific targets were set. First, telephone on demand was to be made available by 2002 and sustained thereafter so as to achieve a teledensity of 7 by the year 2005[106] and 15 by 2010. Second, suitable tariff structure for rural areas had to be set and rural communications made mandatory for all fixed service providers. Third, rural teledensity was to be increased from the 1999 level of 0.4 to 4 by the year 2010 and reliable transmission media to be provided in all rural areas. Fourth, telecom coverage of all villages was to be achieved and reliable media to be made available to all exchanges by 2002. Fifth, Internet access was to be provided to all district head quarters by the year 2000. Finally, high speed data and multimedia capability using technologies such as ISDN (Integrated Services Digital Network) was to be supplied to all towns with a population greater than 200,000 by the year 2002.[107]

The NTP 1999 put forward firm governmental commitments towards the corporatization of the DoT/DTS, the introduction of competition for domestic long-distance services, and an increase in competition for basic

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105 NTP 1999, Section 2.0.

106 India successfully achieved this a year ahead of the target date. In March 2004, teledensity was 7.02. See *Annual Report 2003-2004*, p. 4.

107 NTP 1999, Section 2.0.

and mobile services. The policy aims to create a modern and efficient telecommunications infrastructure taking account of the convergence of electronics, telecom, IT and media. The NTP 1999 thus grouped telecommunications service providers of cellular mobile service, fixed telephony service and cable service under the collective term of 'access providers'.[108]

The following is an overall framework for 'access providers' wishing to provide telecommunications services:

1) An access provider can provide services within its own service area without the need of an additional license.
2) An access provider must obtain a separate license for each service area it wishes to further operate in.
3) A one-off entry fee is applicable.
4) License fee is to be based on revenue share.
5) The TRAI is responsible for recommending the determination of entry fee and selection of additional service operators.[109]

The NTP 1999 also provides a policy framework for cellular mobile service providers (CMSPs). This is a huge departure from the NTP 1994 in that the new policy allows both mobile and private fixed operators to provide *long-distance* services within circle areas. Also a significant departure in the NTP 1999 is the allowance for cable operators to apply for basic licenses, allowing them to provide last-mile linkages and switched services within their areas of operation.

108 Other telecom groups include, for example, national long-distance operators, international long-distance operators, radio paging service providers, among others.
109 The government, however, was not bound by these recommendations.

To implement the NTP 1999 objectives, major changes have been made to the structure of India's telecommunications industry. As a result, national long-distance (NLD) service has been opened for unrestricted entry in August 2000 and as of 31 March 2002, VSNL's monopoly officially ceased. All telecommunications services are now open to private participation and competition. Licensing of all telecoms services is now under the policy framework of the NTP 1999.

There is no limit to the number of operators wishing to provide any type of telecommunications services. However, the applicant for a license must be an Indian company registered under the Indian Companies Act 1956, and foreign equity in the applicant company is restricted to a maximum of 49%.[110] Hence, although the Indian telecommunications sector is open to competition, it has not completely opened up its telecommunications market to foreign penetration or trade in telecommunications services through commercial presence (mode 3).

As to Internet telephony, the NTP 1999 did not permit this in India at that time.[111] Nonetheless, the NTP 1999 stipulated that the government review this issue at a later appropriate date. Accordingly, an expert committee was constituted to review the matter and the government consequently decided to open up Internet telephony. After having considered the TRAI's recommendations[112] on the issue, the government legalized Internet telephony services from 1 April 2002. Internet telephony can provide a cheaper alternative to traditional international telecoms

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110 Government of India, DoT, *Guidelines for the Issue of Licence for Basic Service*, No. 10-2/2000-BS-II, 25 January 2001.
111 NTP 1999, Section 3.2.
112 TRAI, "Recommendations on Opening Up Internet Telephony", 20 February 2002.

services offered by public telecoms operators because they bypass the international accounting rate system where rates are often not cost-based.

The criteria for providing Internet telephony services include principally: only ISP licensees are permitted to offer Internet telephony, and it can only be provided from a personal computer (PC) to another PC (both within and outside India) and from a PC to phones outside India. The conditions for the provision of Internet telephony are thus restrictive. Latest figures show that although there are currently 121 ISPs licensed to offer Internet telephony,[113] they are still in the initial stage of setting up business. Forty-two of these ISPs are currently providing Internet telephony.[114]

Since the launch of the NTP 1999, further liberalization has been pursued, often ahead of schedule. The NTP 1999, however, failed to clearly define TRAI's role.

V. India's WTO Telecommunications Commitments

India was an active member of the GATT and a founding member of the WTO. It strongly favours the multilateral approach to trade relations and is committed, within the WTO, to ensuring that the sectors in which the developing countries enjoy a comparative advantage are adequately opened up to international trade.[115] India recognized the importance of trade in services and had therefore tirelessly contributed to the debate surrounding the liberalization of trade in services and specific sectors like

[113] *Annual Report 2003-2004*, p. 12.
[114] TRAI, *Indicators July-September 2004*, p. 14.
[115] WTO, Press release, 1 April 1998, PRESS/TPRB/71.

telecommunications in both the Uruguay Round and the extended negotiations.

1. *India's Participation in the Uruguay Round and the Negotiations on Basic Telecommunications*

(a) Uruguay Round (1986-1994)

In the working group on telecommunications services (WGTS) during the Uruguay Round, India presented and represented the points of the view of developing countries through its active involvement in the negotiations on an annex, in addition to the general framework on services, for telecommunications. India stressed the fundamental importance of telecommunications for national economies and highlighted the fact that developing countries had poor telecommunications infrastructure and thus trade in telecommunications services, in stark contrast to developed countries, was negligible.[116]

India, together with Egypt, spoke for developing countries in WGTS highlighting the fact that developing country participation was crucial to progressive liberalization and should therefore be encouraged. However, as the telecommunications sector is weak in all developing countries, they should be free to provide incentives to strengthen their domestic capacities with a view to securing a minimum level of domestic operations. India pointed out that in making liberalization commitments at the multilateral

116 GATT, WGTS, *Note on the Meeting of 9-11 July 1990*, MTN.GNS/TEL/2, 6 August 1990, para. 33.

level of the Uruguay Round, reciprocity should not be expected from developing countries within the telecommunications sector.[117]

India took the view that an annex should not be used to impose additional obligations on parties to a general agreement on services. India argued that issues of market access fell within the ambit of the general framework and not the annex.[118]

In making scheduled commitments on telecommunications services, India agreed that the positive list approach was the most appropriate. In this way, there was no need to distinguish between basic and non-basic services. Members list in their schedules those telecommunications services where they wish to allow market access, and those not listed are not subject to the WTO's liberalization process.

Nonetheless, at the end of the Uruguay Round, India, like most other WTO Members, scheduled commitments to liberalize value-added services, but none on basic telecommunications services. India's commitments cover all value-added services,[119] except EDI and code and protocol conversion. India accords full market access and national treatment to foreign suppliers for cross-border supply of value-added services.[120] There are no limitations to national treatment with regard to the supply of value-added services through commercial presence, but there is a restriction of foreign equity ceiling of 51% for market access.[121] India did not make any commitments for consumption abroad nor on presence of natural persons

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[117] *Ibid.*, para. 168.
[118] GATT, WGTS, *Note on the Meeting of 10-12 September 1990,* MTN.GNS/TEL/3, 12 October 1990, para. 174.
[119] WTO, GATS, *India Schedule of Specific Commitments,* GATS/SC/42, 15 April 1994. See Appendix VII.
[120] *Ibid.*
[121] *Ibid.*

(except as indicated in the horizontal section).[122] These relatively liberal commitments with respect to value-added telecommunications services may reflect India's acceptance that unrestricted access to such services is an essential element for attracting foreign direct investment and participating actively in global commerce.

In any case, India's telecommunications commitments scheduled at the end of the Uruguay Round reflected the situation of the telecommunications industry in India at the time: value-added services were liberalized in 1992. They were standstill provisions and were not measures that committed India to liberalize further. Nonetheless, it has been argued that this is not necessarily damaging for the liberalization process.[123] Standstill provisions assist the trade liberalization process by establishing binding benchmarks where few or none had been established before, and by providing some improvement in regulatory transparency. Thus, the schedules of commitments, in combination with the general obligations and provisions for progressive liberalization, provide an effective foundation to support future rounds of negotiations.[124]

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[122] Commitments scheduled in the horizontal section include measures permitting the temporary stay of managers, executives, specialists, business visitors and professionals. Managers, executives, and specialists may reside in India for a maximum of 5 years, while persons visiting for business negotiations, or for conducting preparatory work to establish a commercial presence, may reside for no more than 90 days. Professionals are subject to a 1-year stay. WTO, GATS, *India Schedule of Specific Commitments, Supplement 2*, GATS/SC/42/Suppl.2, 28 July 1995.

[123] U.S. International Trade Commission, "General Agreement on Trade in Services: Examination of the Schedules of Commitments Submitted by Asia/Pacific Trading Partners", August 1997, Investigation No. 332-374, Publication 3053, p. 15-10.

[124] *Ibid.*

(b) Extended negotiations on basic telecommunications (1994-1997)[125]

India became a full participant of the WTO negotiations on basic telecommunications in the fifth meeting of the negotiating group on basic telecommunications (NGBT).[126] India decided to participate in the NGBT on the understanding that the negotiations took place within the framework of the GATS and that progressive liberalization meant that there would be differentiated responsibilities with regard to liberalizing between developed and developing country participants, as granted by Article XIX:2.[127]

In the negotiations on basic telecommunications India stressed that the liberalization of telecommunications should encompass all modes of supply as India attached tremendous importance to the fourth mode – the presence of natural persons – as an area where it possessed competitive strength. India was relying on the special treatment provided in Article IV of the GATS to assist developing country Members in their participation in world trade. At the successful conclusion of the negotiations on basic telecommunications, however, few countries made commitments in the fourth mode of delivery. Neither the US nor the EC, the two strongest advocates of telecommunications liberalization and the two largest markets, made commitments to liberalize trade in telecommunications through the presence of natural persons (except as indicated in its

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125 See also Chapter 3.
126 Meeting of 27-28 February 1995.
127 WTO, NGBT, *Report on the High-level Meeting of 6 October 1995*, S/NGBT/9, 31 October 1995, para. 17.

horizontal section). Consequently, India itself refrained from committing to this mode of delivery.

As discussed above, it has been difficult for developing countries to have confidence in the liberalization of trade in services and commit themselves fully to this process because developed countries have not proved to them by implementing GATS Article IV that liberalizing the services sector would yield benefits to developing countries. And here also with regard to telecommunications, developed countries have not made commitments to liberalize services that are delivered through the fourth mode – which is one of India's reasons for making limited commitments in basic telecommunications.[128]

2. India's Commitments in the Agreement on Basic Telecommunications

At the end of the negotiations on basic telecommunications India made very limited commitments to liberalize its telecommunications sector. India listed voice telephone services, circuit switched data transmission services, facsimile services, private leased circuit services and cellular mobile services in its schedule but only made commitments on market access for mode 3 delivery.[129] No other commitments were made for the other three modes of delivery for either market access or national treatment. Its commitment to market access for commercial presence has a restriction of maximum foreign equity of 25%.

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[128] In the Doha Round of negotiations on services, India's delegate stated that the real test of the negotiations was the extent to which Article IV would be effectively implemented through meaningful commitments by developed countries in sectors and modes of interest to developing countries, such as mode 4. WTO, CTS (Special Session), *Report of the Meeting held on 5 and 6 December 2000*, 2 March 2001, S/CSS/M/7, para. 7.
[129] See Appendix VIII.

(a) A Modified Reference Paper

India made partial commitments pursuant to the WTO Reference Paper on telecommunications services through scheduling as additional commitments in its Schedule modified provisions of the Paper.[130] In fact, all six sections of the Reference Paper have been altered.

i) Competitive Safeguards

Under this section of India's Reference Paper, the provisions apply to all service suppliers and not only to "a major supplier" as in the original. The purpose of having competitive safeguards apply only to major suppliers is to protect new entrants from being 'bullied' out of the market by aggressive anti-competitive tactics used by major suppliers, and so to ensure that competition is effectively introduced into the telecommunications sector. However, since India has omitted "major supplier" in its version of the Reference Paper, a new entrant, although not yet having any significant control of the telecommunications market, could be alleged to engage in anti-competitive behaviour if it carried out either of the two practices listed in India's Reference Paper, namely: i) using information obtained from competitors with anti-competitive results, and ii) not making available to other service suppliers technical information on essential facilities and commercially relevant information which are necessary for them to provide services. This would defeat the Reference Paper's purpose of ensuring

[130] See the US Reference Paper in Appendix V as an example of a fully-committed or "original" Reference Paper. See Appendix VIII for India's Reference Paper (WTO, GATS, "Explanatory Paper on Additional Commitments by India", *India Schedule of Specific Commitments, Supplement 3*, GATS/SC/42/Suppl. 3, 11 April 1997 (India Reference Paper)).

effective competition by keeping the dominant supplier, usually the incumbent operator, 'in check'.

The list of anti-competitive practices in India's Reference Paper is confined to two practices only. The original Reference Paper, on the other hand, contained a non-exhaustive list of anti-competitive practices. Furthermore, India omits "anti-competitive cross-subsidization" from its list. The reason is this: India's telecommunications sector at the time of the extended basic telecoms negotiations was completely run by the DoT, which was also regulator and policy-maker, and the DoT cross-subsidized its telecommunications services, particularly subsidizing local services with revenues from international services. India was not going to make international commitments which clashed with its domestic practices.

ii) Interconnection

The Reference Paper provisions on interconnection have also been modified by India, thus limiting its commitments in the WTO. The original Reference Paper requires that interconnection with a major supplier is ensured at "*any technically* feasible point in the network."[131] India, however, has committed itself to ensure interconnection only at "any *specified* feasible point in the network *as indicated in the license.*"[132] Therefore, where there has been no agreement on a specified point in the network where interconnection is to be accorded, foreign operators cannot rely on India to interconnect them to India's major supplier(s) (at the time

[131] WTO, *Reference Paper,* Section 2.2. Emphasis added.
[132] India Reference Paper, Section 2.2 first sentence. Emphasis added.

was the DoT and now BSNL, MTNL and VSNL) even if it is technically feasible to do so.

Section 2.2(a) of India's Reference Paper omits the obligation to ensure interconnection on non-discriminatory terms, conditions and rates.[133] Non-discrimination is one of the core principles of the WTO. It is a safeguard for equal treatment of all players in trade. Without the obligation to interconnect suppliers of telecommunications services under non-discriminatory terms, conditions and rates foreign suppliers can find themselves being charged more, for example, than Indian suppliers, such as MTNL, for interconnecting to BSNL, India's major supplier. This clearly disadvantages potential competitors to India's major telecommunications operator and thereby obstructs the introduction of competition into the domestic market.

Further modifications to the original Reference Paper include leaving out Section 2.2(b) and altering the wordings of Section 2.2(c) (see Appendices V and VIII). The modifications of both these provisions are with regard to cost-oriented rates and provision of the infrastructures of a major supplier needed by other operators to supply their services. More specifically, India did not commit to provide interconnection,

> in a timely fashion, on terms, conditions (including technical standards and specifications) and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require for the service to be provided.[134]

[133] What India does guarantee is that *quality* of interconnection is not less favourable than that provided for its own like services or for like services of non-affiliated suppliers or for its subsidiaries or other affiliates.
[134] WTO, *Reference Paper*, Section 2.2(b).

Instead India will provide interconnection "upon request, at points in addition to the network termination points offered to the majority of users *as per licence conditions, subject to mutually agreed charges.*"[135]

Section 2.5 on settlement of interconnection disputes is also modified. India has committed to have disputes resolved by a domestic regulatory authority, but not necessarily one that is independent of the major supplier. This is because at the time of the signing of the ABT, India's telecommunications regulator was also its supplier, the DoT.

iii) Universal Service

This provision of the Reference Paper has been modified by India to ensure that its right to enact its universal service policies is uncompromised by its WTO commitments. India regards universal service obligation as not being anti-competitive *per se*, since, claims India, it would be administered in a transparent and non-discriminatory manner. However, India has not bound itself to make sure that such obligations are administered in a transparent, non-discriminatory and competitively neutral manner. By doing so, India allows itself leeway to restrict competition in its telecommunications markets for the purposes of imposing a universal service obligation.

India's policy reason for modifying this provision of the Reference Paper stems from the fear that competition would put the provision of universal services at risk. This was one of the general fears cited by many developing countries for their reluctance to introduce competition into the

[135] Cf. Section 2.2(c) of the original Reference Paper: "[...] subject to charges that reflect the cost of construction of necessary additional facilities".

telecommunications sector (see section II.2 above). As shown above, however, network and services penetration seem to have increased with the introduction of competition.

iv) Public availability of licensing criteria

Again India made a few changes to the Reference Paper. It commits to provide all the licensing criteria where a license is required but it is not obliged to make publicly known how long it would take to issue a license nor to give reasons for the denial of a license.

v) Regulatory Authority

On the provision for an independent regulatory body, Section 5 of the Reference Paper, India committed itself only to the second requirement: "The decisions of and the procedures used by the regulatory authority shall be impartial with respect to all market participants." India omitted the first phrase: "The regulatory body is separate from, and not accountable to, any supplier of basic telecommunications services." At the time of the negotiations on basic telecommunications, an independent regulatory authority which was to be the TRAI was under consideration. The TRAI was established in January 1997, at the time of the conclusion of the basic telecoms negotiations. It thus seems odd that India, having already established an independent regulatory authority by the time of its signing to the ABT, should refrain from making full commitment to the corresponding provision in the Reference Paper.

A closer look, however, reveals the reasons behind such limited commitment. Although a regulatory authority was being established outside the DoT, also the country's telecommunications provider, it was not intended to be truly independent. The TRAI was financially dependent on the DoT and although the TRAI was responsible for making recommendations on granting new licenses, the DoT was not obligated to put any of these recommendations into action. The TRAI was thus not truly separate from and was to some extent still accountable to the basic telecommunications supplier.[136]

vi) Allocation of scarce resources

India has committed to carry out procedures for the allocation of the use of scarce resources in an objective and timely manner but makes no mention of transparency or non-discrimination as contained in the original Reference Paper. India has not committed to making the current state of allocated frequency bands publicly available.[137] This could be for national security reasons.

(b) Additional Commitments and Exemptions

Further additional commitments scheduled by India include the commitment to review the opening up of NLD service beyond the service

136 India's initial services offer in the GATS 2000 negotiations now includes a full commitment with regard to the Reference Paper's provision on independent regulators. See Appendix IX.

137 India's initial offer in GATS 2000 has now added this commitment. See Appendix IX.

area to competition in 1999,[138] and the commitment to review the opening up of international services to competition in 2004.

India was among the nine WTO Members that maintained MFN exemptions concerning basic telecommunications (as permitted under GATS Article II) and annexed them to the Fourth Protocol. India's MFN exemptions are with regard to accounting rates. Although it was agreed by WTO Members that the issue of differential accounting rates would not be subject to dispute resolution in the WTO, India nonetheless felt the need to schedule them as MFN exemptions. Four other countries also maintained MFN exemptions in respect of the application of differential accounting rates to services and service suppliers of other Members.[139]

VI. Implementation of India's WTO Commitments: Telecommunications in Practice

To determine the extent of India's implementation of its WTO commitments in telecommunications, this section examines India's domestic policy on telecommunications. Surprisingly, India's telecoms policy is generally more liberal than its scheduled bindings regarding the liberalization of this sector. Proposals to liberalize telecommunications in India have long been opposed by the labour wing of the previous Prime Minister's[140] Bharatiya Janata Party (BJP), which ran the country's biggest trade union and feared that jobs would be lost, and by the cultural wing, which worried that foreigners would end up controlling India's

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[138] This commitment was reinforced by the NTP 1999, which declared that the market for NLD should be opened up to competition in January 2000.

[139] They are Bangladesh, Pakistan, Sri Lanka and Turkey.

[140] The Prime Minister in question was Atal Berhari Vajpayee. His terms of office as Prime Minister were from 16 May 1996 -1 June 1996, 19 March 1998-13 October 1999, and 13 October 1999 to May 2004.

telecommunications industry. As the new millennium was approaching and India's IT sector was growing rapidly, the Prime Minister saw the benefits and the need to modernize and speed up the liberalization process of India's telecommunications sector. As has been pointed out,

> There is no question that liberalization is beneficial and that countries should liberalize. However, this is not always the case in practice, and even more rarely so in developing countries.[141]

1. Autonomous Liberalization

India, like many developing countries, although having made limited WTO commitments to liberalize telecommunications services, has over the past few years liberalized the telecommunications sector autonomously. A significant step was the introduction of competition in international telecommunications services in April 2002, which began the liberalization process in this sector two years earlier than required by its WTO commitments.[142] As seen above, today there are three other operators competing against the incumbent VSNL in the provision of international services. It will nonetheless take some time before any new entrants can pose any real threat to the recently de-monopolized VSNL, but it is the right step towards further liberalization in telecommunications.

With regard to the liberalization of trade in telecommunications through commercial presence, India allows in a company providing basic telecoms service foreign equity not exceeding 49 per cent. The company

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[141] Caglar Ozden speaking at the World Bank on the paper by himself and Eric Reinhardt titled "The Perversity of Preferences", available at http://www.worldbank.org/wbi/B-SPAN/sub_perversity.htm.

[142] Another significant step taken by the government in the telecommunications sector was the privatization of VSNL in February 2002 which was described as the "most important" privatization in India. *The Economist*, "Privatization in India; An Incredible Shrinking Government", 7 February 2002.

must, however, be registered under the Indian Companies Act of 1956. A foreign equity ceiling of 49% is an improvement from that listed in India's WTO Schedule on telecommunications (maximum foreign equity of 25%).

The process of liberalization in telecommunications was pushed forward by Prime Minister Vajpayee, who wanted to be remembered as the leader who ushered in the era of information technology.[143] He fully opened up the NLD market to competition on 15 August 2000, India's independence day. India's own telecoms commission had wanted to liberalize gradually, by allowing just four private operators to bid for licenses. The Prime Minister, however, thought the process would be too lengthy and would be plagued by legal challenges. In his view, the aim should be to get the most telephone connections rather than the highest license fees.[144] Now there will be no limit to the number of licenses available. Operators will simply pay the government a fixed fee and a share of their revenue. Today, four companies (including the incumbent BSNL) provide NLD services.[145] Bharti Tele-Ventures was the first to offer a challenge to the long-distance monopoly of BSNL in January 2002.[146]

In the area of basic fixed local telephone services, competition has been encouraged since 1994 as a major policy of the NTP 1994. In contrast to most other governments, India liberalized its local basic telecoms market before its NLD and international services markets. Currently, five licensed private operators provide fixed line services in

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143 *The Economist*, "When India Wires Up", 20 July 2000.
144 One of the reasons why the Indian Prime Minister wanted to see the deregulation of NLD services was because India is falling well behind the rest of Asia in its use of new technologies, such as the Internet, and old ones like the telephone. *Ibid.*
145 The other three are Bharti Infotel which started its service on 26 January 2002; VSNL which commenced its operation on 25 September 2002; and Reliance Infocomm which started providing NLD services on 1 May 2003.
146 *The Economist*, "Connecting Competition", 4 April 2002.

addition to the incumbents BSNL and MTNL.[147] The number of subscribers served by private basic telecoms providers increased from 272,761 in April 2001 to 447,618 in December 2001.[148] As of September 2004, the subscriber base of private operators stood at around 3.5 million.[149] This, however, is a tiny 8 per cent share of the total fixed line subscriber base of 43.9 million.[150] The state-owned operators BSNL and MTNL have 83% and 9% market share respectively. Most strikingly, private operators only have a 0.11% share of the rural market in fixed lines while BSNL controls 99.89%.[151]

Significantly, nonetheless, all telecommunications services are now opened to competition and private participation. This has allowed the cost of mobile phone calls to fall by 90% over the past 3 years, and NLD rates dropped by 60% in January 2002.[152] International rates are already beginning to decrease since the introduction of competition in April 2002.

2. An Independent Regulator: the TRAI

A strong independent regulator is essential to providing a competitive and effective telecommunications sector. It is one of the issues considered in the WTO to be an essential part of the liberalization process. India established the Telecom Regulatory Authority of India (TRAI) in January 1997 by the Telecom Regulatory Authority of India Act 1997[153] to separate

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[147] These five are Bharti, Tata Teleservices, HFCL Infotel, Shyam Telelink, and Reliance Infocomm Ltd.
[148] *Annual Report 2001-2002*, p. 17.
[149] TRAI, *Indicators July-September 2004*, p.6-7.
[150] *Ibid.*
[151] *Ibid.*
[152] *The Economist*, "Privatization in India: An Incredible Shrinking Government", 7 February 2002.
[153] Section 3 Telecom Regulatory Authority of India Act 1997 (TRAI Act 1997).

the regulatory functions from policy formulation and operational functions in the telecommunications sector. The TRAI was established in response to pressures from foreign investors who were aggrieved by the unstable market and investment environment in the Indian telecommunications sector, and who consequently pulled out of India one by one.[154]

The 1997 Act also gave the TRAI a dispute settlement role. The TRAI was to settle disputes arising among service providers or between service providers and a group of consumers.[155] However, the TRAI was to be "effectively stripped of its judicial powers"[156] by the Telecom Regulatory Authority of India (Amendment) Ordinance 2000. The 2000 Ordinance made a few amendments to the 1997 Act, one being the establishment of a separate disputes settlement body known as the Telecom Disputes Settlement and Appellate Tribunal (TDSAT).[157] The new dispute settlement body is to adjudicate any dispute between a licensor and a licensee, between two or more service providers and between a service provider and a group of consumers.[158] The TRAI was also reduced in size by the 2000 Ordinance.[159]

From the moment the TRAI was created, its powers were challenged by the DoT who feared its influence in the telecommunications industry was in jeopardy. The DoT brought cases against almost every direction made by the TRAI. One of the most contentious issues was in the area of interconnection, especially with regard to cellular operators and fixed

154 A. Achar, "Untangling a telecoms revolution: Central Asia-India", *Telecommunications Online* (October 1999).
155 Section 14(1) TRAI Act 1997.
156 L. Srivastava and S. Sinha (2000), p. 16.
157 Section 11 The Telecom Regulatory Authority of India (Amendment) Ordinance, 2000. (Hereinafter TRAI Ordinance 2000).
158 *Ibid.*
159 The TRAI was reduced from a maximum of six members and a Chairperson to a maximum of two whole time members and two part-time members and a Chairperson. Terms of office for the Chairperson and members have also been reduced from six years to three years. Section 4 and Section 6 TRAI Ordinance 2000, respectively.

operators. When the TRAI introduced the policy of Calling Party Pays (CPP), proceedings were brought against this order (originally by a consumer group but later joined by MTNL).[160]

The High Court ruling that the TRAI did not have jurisdiction to implement the CPP Regime of 1999 resulted in amendment to the powers of the TRAI in the 2000 Ordinance: Section 11(1)(b)(ii) of the 1997 Act was amended to allow the TRAI to "fix the terms and conditions of inter-connectivity between the service providers".[161] The amendment was made in order to make a clear distinction between the regulatory and recommendation functions of the TRAI. With this new power, the TRAI adopted the Telecommunication Interconnection Usage Charges (IUC) Regulation 2003 which re-introduced the CPP policy.[162] The CPP regime finally came into effect on 1 May 2003.[163]

The TRAI has the power to regulate tariffs and terms and conditions of interconnection.[164] However, it can only recommend terms and conditions of licenses and the need for the introduction of new service providers.[165] The government must invite the TRAI's recommendations before issuing licenses, but these recommendations are not binding on the government. The TRAI also does not have the authority to issue further licenses or the authority to allocate spectrum frequencies for wireless communications. However, the TRAI's decision in the areas of tariff fixing, interconnection, including tariffs and technology and laying down quality standards, are mandatory for the government.

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160 See L. Srivastava and S. Sinha (2000), p. 33.
161 Section 9 TRAI Ordinance 2000.
162 TRAI, Notification, "Telecommunication Interconnection Usage Charges (IUC) Regulation 2003", 24 January 2003.
163 TRAI, Notification, "Telecommunication Interconnection Usage Charges (IUC) (First Amendment) Regulation 2003", 27 March 2003.
164 Section 9(a) TRAI Ordinance 2000.
165 *Ibid.*

The US has raised concerns at the weak enforcement powers of the TRAI and about apparent conflicts of interest arising out of the Indian government's ownership interest in India's telecom operators.[166] India still lacks a strong independent regulatory body. It also needs a regulator that can keep up with the market. Charges of regulatory bad faith are among the reasons why foreign investors have largely stayed away from India.[167] The Communications Commission of India, which will be established when the Communication Convergence Bill becomes law, will replace the TRAI as the new autonomous regulator of communications. The extent of this autonomy is discussed below.

VII. Further Liberalization: Domestic Regulatory Reforms and A New Communications Bill

Despite the liberalization of India's telecommunications sector having begun in the early 1990s, basic fixed telecommunications services are today dominated by three enterprises, two of which are state-owned (BSNL and MTNL). Liberalization, however, has been steadily taking place over the past two years in various sectors of India's fast-growing telecommunications industry.

1. Telecommunications Expansion in India

One area that required further liberalization was in the fundamental issue of interconnection, which is "the cornerstone to a truly competitive

166 USTR, "Results of the 2002 "Section 1377" Review of Telecommunications Trade Agreements". Available at http://www.ustr.gov.
167 *The Economist*, "Connecting Competition", 4 April 2002.

market. The power to interconnect increases the value of any network and the inability to do so can be a severe barrier to entry".[168] In India, interconnection has been one of the main stumbling blocks in the development of mobile interconnection. In order to terminate their calls, mobile operators are forced to interconnect with MTNL in Delhi and Mumbai, and BSNL for local and long-distance connections in other regions. They also need access to VSNL's gateways for routing international traffic.

Negotiating effective interconnection has been a daunting task for these operators. Prior to the CPP regime mobile/fixed interconnection was governed by the receiving party pays (RPP) system. Under the RPP, fixed operators (usually BSNL and MTNL) did not pay any access charges (interconnection fees) to mobile operators to terminate calls originating from fixed lines to mobile networks. Furthermore, in the case of mobile to fixed calls, the mobile operators paid the incumbent fixed operators the full local call charge. There was no revenue sharing arrangement between mobile and fixed operators. The RPP regime resulted in exorbitant costs to mobile operators and thus high rates charged to mobile users. The incumbent fixed operators insisted on maintaining the RPP system. This was because high access charges paid to them by mobile operators were used by the incumbents to subsidize services such as cheap local fixed calls, roll-out of networks to unprofitable rural areas and free-number services. The consequence, however, was restricted competition in India's telecommunications market.

[168] Srivastava and Sinha (2000), p. 26. See also the historical importance of interconnection in the early years of the US telecoms industry in Chapter 2, Section I.4.

Mobile operators represent the only significant private sector presence in Indian telecommunications and are a major source of competition to the state-owned BSNL. Mobile operators, aided by the implementation of the CPP regime, are playing a key role in the future development of the telecommunications sector in India. In fact, mobile phones significantly contributed to India meeting its teledensity target of 7 by 2005 – mobile phones, including WLL phones,[169] made up 44% of India's total telephones in March 2004.[170] By the end of November 2004 the teledensity in India stood at around 8.37.[171] Between March and November 2004, there were over 14 million new telephone connections, 88% of which were mobile phones.[172] As of December 2004, there were 46 million mobile phones[173] compared to 44.5 million fixed line connections.[174] Mainly due to mobile phones, private sector share of the Indian telecommunications market at the end of March 2004 was 39.27% - a promising 18.31% increase from the year before.[175]

India's telecommunications has also experienced significant developments in the Internet sector. To promote the sector, India began issuing licenses on a non-exclusive basis from November 1998 and allowed ISPs to setup their own international gateways using satellite and submarine cable landing stations. Furthermore, India's ISP Policy

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169 WLL stands for Wireless Local Loop technology. WLL was introduced in India to promptly expand telephone connections. WLL connects a phone in a home or office to a fixed telephone network through wireless technology. It differs from the standard local loop in that WLL does not use copper wires or cable to connect to the public switched telephone network (PSTN). WLL is also different from cellular mobile phones because they are not truly mobile. WLL is also known as fixed wireless. WLL allows for shorter construction period and reduces installation and operation costs. Private operators used WLL in the initial stages of their network rollout when the Indian telecoms market was opened to competition in order to quicken their entry into the market.

170 *Annual Report 2003-2004*, p. I.

171 *The Economic Times Online*, "Tele-density moves up", 2 January 2005.

172 *Ibid.*

173 This figure includes WLL phones.

174 *The Economic Times Online*, 2 January 2005.

175 *Annual Report 2003-2004*, p. I.

advanced liberalization by allowing a maximum foreign equity of 74% in ISPs and even up to 100% in cases where the ISP does not set up an international gateway. In addition, as we have seen above, India has legalized voice Internet telephony.[176]

More recently, India has adopted the Broadband Policy 2004[177] in a move to take India into the information super-highway digital age and catch up with its Asian neighbours.[178] In January 2005, BSNL launched its first broadband service "Data One" in over 200 cities across India. Prior to this, broadband penetration in India was only around 0.02%.[179] To hasten broadband rollout TRAI has proposed local loop unbundling (LLU), following the regulatory trends in the EU and the US.[180]

In another liberalization move, the government, on the recommendation of the TRAI, adopted the Unified Access Service License regime in November 2003. This new regime permits operators to offer both fixed-wire and cellular services in the same service area – previously prohibited by the former licensing regime.[181] Since the Unified Access regime came into effect, 27 licenses out of 31 basic service licenses have been converted into a Unified Access Service License.[182] This regime is likely to result in better services at lower tariffs, increasing competition among providers, and, because it gives players the means to make fixed

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[176] See Section IV.2 above.
[177] DoT, *Broadband Policy 2004*, File No.813-07/03-LR, available at http://www.dot.gov.in.
[178] See TRAI, "TRAI releases recommendations on Broadband India", Press Release No. 30/2004, 29 April 2004.
[179] *The Financial Express*, "Broadband ... ready to take off", 6 January 2005.
[180] See *The Hindu, Business Line*, "For a new telecom mantra", 1 July 2004; see TRAI, "Recommendation for allowing copper cable in last mile", 18 March 2004.
[181] The Unified Access Service License Regime is the first part of the recommended unified license/authorization regime which is to be achieved in a two-stage process. The unified license/authorization regime when implemented in full envisages service providers to be able to offer *any* or *all* services *using any technology* in the defined area of operation in a liberalizing move to promote greater participation of all types of entrepreneurs. Meanwhile, the second phase of the proposed unified license is in its consultation stage. *Annual Report 2003-2004*, p. 6.
[182] *Annual Report 2003-2004*, p. I.

wireless connections fully mobile by acquiring cellular operation licenses on very favourable licensing conditions, will boost the growth of the WLL sector.[183] The regime has already led to growth in mobile subscriber base and the resulting price decreases.[184]

Connecting all of India's rural population to the country's communications network has however proved more formidable. The NTP 1999 stated as one of its objectives to achieve telecom coverage of all villages by 2002. As of September 2004, however, there were still 83, 190 villages (13%) left uncovered (524,301 villages out of 607,491 (87%) have been connected through the provision of village public telephones (VPTs)).[185] Nonetheless, with the implementation of the Universal Service Obligation (USO) Fund in March 2004, it is expected that India's entire rural community would be connected in the near future.[186]

Further implementation of its WTO commitments, or more correctly further autonomous liberalization of India's telecommunications sector, is in the form of the Communications Convergence Bill, introduced in 2000 and has yet to become law.

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183 EuroIndia 2004 Co-operation Forum on the Information Society, "EuroIndia 2004 Market Background Document Overview", p. 6, at http://www.euroindia2004.org.

184 *Annual Report 2003-2004*, p. 6.

185 TRAI, *Indicators July-September 2004*, para. 1.2.2.

186 *Annual Report 2003-2004*, p. III. The USO Fund was established by the Indian Telegraph (Amendment) Rules 2004, *The Gazette of India*, Extraordinary, Part II-Section 3-Sub-section (i), 26 March 2004. It determines that a USO Fund will be used to support the Universal Service Providers (selected through a bidding process from among basic service operators, cellular mobile operators and unified access service licensees) in their provision of public telephone services and rollout and maintenance of services to rural areas.

2. *The Communications Convergence Bill 2001*

The Communications Convergence Bill 2001[187] was introduced into Parliament ("Lok Sabha") on 31 August 2001 and was expected to become law in the summer of 2002. The Bill was put on hold in 2003 because of certain unresolved issues mainly regarding the regulation of content and whether India was ready to have a super regulator. The question was whether it was better to have one regulator oversee communications services and another separate one to regulate content. The issue of content regulation is particularly important to India's policies on the protection of its cultural identity and the safeguarding of national security.[188] The Bill is currently still under consideration.

India had hoped to develop and modernize its entire telecommunications system by introducing a new piece of legislation that is comprehensive in scope and effectiveness to address the convergence of communications, and is intended to remain valid over time, technologies and industries. The Indian government desired to make India, through the new legislation, a country with a complete convergence law.[189]

The Communications Convergence Bill, when it becomes law, will repeal five existing legislation: the Indian Telegraph Act 1885, the Indian Wireless Telegraphy Act 1933, the Telegraph Wires (Unlawful Possession)

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[187] The original title was the Communications Convergence Bill 2000. A revised draft was submitted to Parliament in 2001 and the title was finalized as the Communications Convergence Bill 2001. (Hereinafter CCB 2001).

[188] See above Section II.2.

[189] The Indian government's ambition to achieve such a complete convergence law was coupled with the belief that the US and Malaysia, countries who have passed convergence law prior to India, have addressed the convergence issue in a "limited" way. Ministry of Information Technology (India), IT News, "Convergence Bill gets GoM nod, commission likely by 2002, from *Economic Times*, 17 January 2001.

Act 1950, the Cable Television Networks (Regulation) Act 1995, and the Telecom Regulatory Authority of India Act 1997. The Bill has four main objectives:

(i) to facilitate development of national infrastructure for an information-based society, and to enable access thereto;
(ii) to provide a choice of services to the people with a view to promoting plurality of news, views and information;
(iii) to establish a regulatory framework for carriage and content of communication in the scenario of convergence of telecommunication, broadcasting, data-communication, multimedia and other related technologies and services; and
(iv) to establish the powers, procedures and functions of a single regulatory and licensing authority and of the Appellate Tribunal.[190]

One of the salient features of the Bill is the creation of a new autonomous regulator which will replace the TRAI. The Communications Commission of India (CCI), the new regulator, would be vested with the powers to grant licenses,[191] manage spectrum for commercial use,[192] determine the conditions for fair, equitable and non-discriminatory access to network facility and service,[193] and resolve disputes.[194] It will consist of a Chairperson and seven Members serving terms of five years. This is an increase in size from the TRAI which had its size reduced by the 2000 Ordinance.[195]

The CCI is, according to the proponents of the Bill, meant to be a truly independent body in every sense. This would rectify the weak powers and lack of autonomy of the TRAI. Thus, although India limited its WTO commitments in the Reference Paper with regard to an independent regulator (see above), the establishment of the CCI accounts for India's

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190 Preamble, CCB 2001.
191 The Bill envisages giving licenses to all communications services under four broad categories of network facilities which are technology-neutral and sector-neutral: 1) network infrastructure facilities, 2) networking services, 3) application services, and 4) content application services. Section 20(2)(ii)-(iv), Appendices I and II, CCB 2001.
192 Section 20(2)(i) CCB 2001.
193 Section 20(2)(vi) CCB2001.
194 Section 22 CCB 2001.
195 See Section VI.2 above.

move to liberalize autonomously. India could use this action to support its position in the current Doha negotiations on telecommunications services. Perhaps it might even consider making changes to its scheduled commitments on telecommunications and adopting the Reference Paper in full.

In reality, however, this will probably not happen. On a closer look at the Communications Convergence Bill, we discover that the CCI is not truly autonomous. For instance, India's central government controls the appointment of the members of the CCI, as well as the removal of such members.[196] Furthermore, and very importantly, the CCI will not be independent of the government in exercising its licensing and regulatory functions as,

> [T]he Commission shall follow such policy directives as may be communicated to it in writing by the Central Government [...] and the decision of the Central Government whether a question is one of policy or not shall be final.[197]

Thus, if there is a conflict between law and policy, policy will prevail.[198]

The Bill seems to provide no limit to the areas where the government may intervene. For instance, although the CCI will manage and assign spectrum to users, it is the central government which is responsible for the allocation of available spectrum.[199] In addition, the government can direct the CCI to assign spectrum to certain classes of persons as it deems fit.[200] Furthermore, the Bill gives open-ended power to the government to

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[196] Sections 7(1) and 8(A), CCB 2001. Cf. the US Communications Act of 1934 as amended by the 1996 Telecommunications Act. In the US, the FCC's five Commissioners are appointed by the President but subject to the Senate's consent. See Chapter 2, Section II.3(a).

[197] Sections 23(1) and 23(3), CCB 2001. Cf. the FCC's broad power to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with [the 1934] Act, as may be necessary in the execution of is functions." 47 U.S.C. 154. See Chapter 2, Section II.3(b).

[198] Beth Noveck, "India's Communications Convergence Bill", 15 April 2001. Available at http://www.bethnoveck.com/papersandpubs/html.

[199] Section 24(1) CCB 2001.

[200] Section 25(2) CCB 2001.

make rules for carrying out provisions of the Act, where such rules may provide for "any other matter which is or may be required to be provided by way of rules".[201] This pervasive interference of the central government in communications regulation subjects policy to undesirable political discretion, creating a climate of uncertainty for the sector. The lack of any power for the CCI to contradict the government strips it of independence.

In addition, there is no requirement that the CCI's decision-making be transparent and subject to public scrutiny. The Bill only requires that the CCI, while exercising its functions, "be guided" by the principle that "licensing criteria are transparent and made known to the public".[202] The CCI must also submit an annual report on its financial activities to the Central Government which will be laid before the Houses of Parliament,[203] but the Bill contains no provisions requiring the CCI to make these reports and information available to the general public. In contrast, the US regulator the FCC is legally required to make public its proceedings upon request by any party (not just the government); must enter as record every vote and official act it takes; must enter as record all reports of investigations it makes; and must publish its reports and decisions for public information and use.[204]

A closer look therefore reveals that the new communications regulator of India is neither truly independent nor transparent. This is a situation which India should remedy before the Bill becomes law if it wants to become an information society with a modernized communications sector as intended by the original introduction of the

[201] Sections 83(1) and 83(2)(x) CCB 2001.
[202] Section 19(ix), CCB 2001.
[203] Section 58A(1), CCB 2001.
[204] Section 4 (j)-(m) Communications Act 1934 as amended.

Communications Convergence Bill.

Another salient feature of the Bill is that the CCI will regulate not only the carriage of communications, but also its content.[205] Firstly, the CCI can "take steps to regulate or curtail the harmful and illegal content on the internet and other communication services".[206] The difficulty here is the precise meaning of "harmful", which is not defined in the Bill nor clarified any further. The lack of such a definition can lead to unlimited intervention by the CCI on what it deems to be harmful and the censorship of any content it does not approve. This could be used to restrict political speech and curtail freedom of expression, contrary to fundamental democratic rights.[207]

Secondly, the Commission will be required to enact regulation that is tantamount to social regulation.[208] Section 21 of the Bill states that the Commission shall enact regulations to: (i) ensure that nothing is contained in any programme which is prejudicial to the interests of the sovereignty and integrity of India; (ii) ensure fairness and impartiality in the presentation of news; (iii) ensure emphasis on the promotion of Indian culture; (iv) ensure decency in the portrayal of women and restraint in the portrayal of violence and sexual conduct; and (v) enhance general standards of good taste, decency and morality. While the protection of local values and traditions is a valid goal, this provision accords too much discretionary power to the Commission to censor free speech.

The Bill, if enacted in its present form, would give India a telecommunications legislation that has been described as attempting "to

[205] Sections 20(2)(viii) and (x) and Section 21, CCB 2001.
[206] Section 20(2)(x), CCB 2001.
[207] B. Noveck, (2001).
[208] Tata Energy Research Institute, "Communications Convergence Bill, 2001", *TERIvision*, October 2001, Issue No. 39.

cover so much ground (broadcasting, telecom, Internet services) and yet does so in such a cursory and vague manner as to be almost unintelligible".[209] In effect, adopting the Bill as it is will provide no predictability, stability or transparency to the regulation of India's telecommunications industry and as a result will not help implement GATS principles on telecommunications liberalization.

VIII. Concluding Remarks

The services sector remains crucial to India's economy, accounting for 49% of GDP in 2000/2001.[210] Stronger efforts to liberalize the telecommunications sector in India, together with those already in operation for financial services, would on all the evidence certainly contribute to higher efficiency of India's industry and its ability to compete with other nations.

India is embarking on domestic regulatory reform of its telecommunications sector: noticeable improvements were made in 2003-2004. For example, TRAI has decreased the access deficit charge (interconnection fees); the CPP regime has finally been implemented; license fees have been lowered; and a regulatory scheme for better interconnection deals for mobile operators has been adopted (this will allow new entrants into the market and thereby increase trade). These reforms will lower costs for competitors and thereby better the environment to compete against incumbents.

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209 B. Noveck (2001), p.2.
210 WTO, TPRB, *Trade Policy Review, India: Report by the Secretariat*, WT/TPR/S/100, 22 May 2002, p. 117, para. 69.

Thus, although India has not made extensive commitments in the WTO on telecommunications services, it has adopted autonomous measures within its domestic sector to liberalize its telecommunications industry. India must now also embrace the liberalization of trade in telecommunications services through making more commitments in the WTO. For example, trade in basic telecoms services through cross-border supply is still unbound for both market access and national treatment.[211] India is therefore not bound to provide cost-based interconnection for cross-border supply of telecoms services or even to ensure the cross-border supply of telecoms services. In not committing in this way India cannot be held accountable, unlike Mexico, for using the above-cost accounting rate system. Nonetheless, India is itself initiating a move towards cost-based tariff rates both domestically and internationally.

It could be argued that international commitments could encourage a country to embark on domestic regulatory reform that would benefit them. Thus India should undertake greater liberalization commitments in the WTO in order to hasten its telecoms regulatory reforms and bring its straggling industry up to speed. The greatest areas of potential growth in telecoms trade in India are in mobile services and the Internet. In a positive move, India has adopted reforms to its telecoms rules and policies that are geared to attract foreign investment in these areas. Regrettably, with regard to making international commitments, India's initial offer on services tabled in the WTO in December 2003 as part of the current negotiations on trade in services contains again unduly limited commitments on telecommunications services.[212]

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211 See Appendix IX.

212 For example, the scheduled maximum foreign equity for commercial presence remains a low 25% although in practice India allows maximum 49% foreign equity. See Appendix IX.

The issue of autonomous liberalization in the current round of WTO negotiations is of crucial importance to India and to other developing country Members. India should not pass up this opportunity in the Doha Round to transform into binding commitments the liberalization measures adopted autonomously. Through setting an example to other developing countries, this would contribute to the strengthening of the multilateral trading system of the WTO. India needs only to show the courage of its convictions.

Chapter 6

Conclusion

The liberalization of trade in telecommunications services involves the interplay between the multilateral rules of the WTO and the domestic law and policies of Member States. It consists of three inter-dependent dimensions: international, domestic, and the implementation of the international through the domestic.

Crucial to the liberalization of trade in telecommunications services under the GATS rules is the clear, accurate and generous scheduling of commitments. WTO Members need to schedule their commitments in as clearly defined and precise terms as possible in accordance with the GATS provisions in order to strengthen the liberalization process of the WTO multilateral trading system. As the first WTO case on telecommunications services shows, interpreting Mexico's commitments was at the heart of the dispute between the Parties and the decision brought transparency and clarification to Mexico's commitment to liberalize.

To some developed countries, such as the US, the GATS rules do not go far enough to liberalize trade in telecommunications services. The Reference Paper on pro-competitive regulatory principles was adopted in response to the US position. Some regard the flexibility of the GATS, for example the positive list approach of scheduling commitments, as a weakness. To developing countries, however, the provisions in the GATS do not allow them enough room to manoeuvre. They would prefer special and differential treatment along the same lines as the GATT. The GATS, however, only provides for special treatment for developing countries in limited situations.

Developed countries, particularly the US and the European Union and its Member States, have an important role to play in leading the multilateral trading system of the WTO towards further liberalization by opening up their markets to foreign competition and giving effective implementation to the multilateral rules on trade in services, and particularly trade in telecommunications services, in their domestic markets. The US and the EC must set examples in trade liberalization. Since they have fully committed to telecommunications liberalization for all types of supply of trade in services, with the exception of mode 4, including adopting the Reference Paper in full, they must now ensure that the telecommunications sectors in their respective countries are and remain fully competitive in practice. Following that, domestic regulation should be lightened and then removed in order to allow for the workings of competition law to take over in the 'free-market' monitoring and 'regulating' of a competitive and liberalized telecommunications sector.

The liberalization of telecommunications services within the WTO has taken the form of the transplantation of US and EC domestic laws and policies into the GATS and the Agreement on Basic Telecommunications. The Reference Paper also reflects the US experience. Developing countries will find themselves incorporating and implementing US and EC policies and legal concepts on the liberalization of telecommunications services if they commit fully to the WTO rules on services liberalization and in particular to the pro-competitive principles contained in the Reference Paper. However, this should not be a reason for developing countries not to commit fully to the WTO liberalization of telecommunications services.

Telecommunications liberalization is crucial to development and has been shown in practice to provide greater efficiency and growth in countries' economies. Even for the developing countries, particularly India, telecommunications liberalization can bring enormous benefits if the GATS multilateral framework is committed to in full, particularly the Reference Paper, and more importantly if it is implemented in full and accurately in the domestic regulatory framework.

Developing countries, nevertheless, will require substantial domestic regulatory reform to re-structure their telecommunications systems to comply with the WTO framework. The problem with the liberalization of trade in telecommunications in developing countries is that they have made limited WTO commitments. Developing countries should schedule more market access commitments in telecommunications services. Nonetheless, allowance should be made for special and preferential treatment for developing countries in order to assist them in making their liberalization process smoother, in particular by allowing them more time to implement their multilateral commitments to liberalize telecommunications services as well as to accord them greater recognition of their autonomous liberalization efforts. If they are not ready to commit to the liberalization of telecoms services in full at the present moment, they could enter phase-in commitments. At least by committing themselves to future liberalization, developing countries can give themselves a concrete reason to embark on domestic reform in an effort to fulfil their commitments and thereby help move the liberalization process of trade in telecommunications services forward.

Developing countries have adopted autonomous measures to liberalize their domestic telecommunications markets. However, they need to go further and schedule these measures. Through scheduling autonomous liberalization measures, developing countries would contribute to promoting the stability and reciprocity of the multilateral trading system by upholding the core principles of transparency, non-discrimination and progressive liberalization. In addition, through such commitments, developing countries could increase their own participation in trade. Without making liberalizing commitments in the WTO, developing countries deny themselves the benefits of access to other countries' markets through global trade in telecommunications services. Furthermore, the purpose of the WTO multilateral trading system is to move forward from unilateral measures of deregulation to a system of world-wide binding obligations. By not scheduling their autonomous measures, developing countries risk stalling the entire multilateral process.

The WTO dispute settlement system can be used to 'regulate' trade in telecommunications services and further its liberalization. This can be achieved by enforcing a Member's commitments by bringing a case before a WTO panel, as was done for the first time when the US took Mexico before the WTO Dispute Settlement Body. A Member's domestic regulatory reform in telecommunications can thus be advanced through the enforcement of its international commitments.

The thesis concludes that adherence to the WTO framework on the liberalization of trade in services, and telecommunications services more specifically, provides for transparency, predictability and stability that developed and developing countries alike need in order to reap the economic benefits that liberalization can offer. It has shown that the movement in both developed and developing countries is now uniformly towards liberalization and competition in telecommunications services. However, domestic deregulation does not equate to trade liberalization. In particular, it does not mean that there are improvements in access to the domestic market for foreign suppliers. In order to achieve the liberalization of trade in telecommunications services within the GATS framework, a combination of trade liberalization – the removal of discriminatory restrictions to foreign suppliers – and domestic regulatory reform – the removal of non-discriminatory measures that restrict trade in services – must be applied. This liberalization of trade in telecommunications services, like all services liberalization, is about the balancing of competing interests: particularly between developed and developing countries, between international and domestic, between economic and social. This may not come as a surprise, but it should constantly be borne in mind by States, especially developing States, as the onward rush towards liberalization continues to gain pace.

APPENDICES

APPENDIX I

ANNEX ON TELECOMMUNICATIONS

1. *Objectives*

Recognizing the specificities of the telecommunications services sector and, in particular, its dual role as a distinct sector of economic activity and as the underlying transport means for other economic activities, the Members have agreed to the following Annex with the objective of elaborating upon the provisions of the Agreement with respect to measures affecting access to and use of public telecommunications transport networks and services. Accordingly, this Annex provides notes and supplementary provisions to the Agreement.

2. *Scope*

(a) This Annex shall apply to all measures of a Member that affect access to and use of public telecommunications transport networks and services.[1]

(b) This Annex shall not apply to measures affecting the cable or broadcast distribution of radio or television programming.

(c) Nothing in this Annex shall be construed:

(i) to require a Member to authorize a service supplier of any other Member to establish, construct, acquire, lease, operate, or supply telecommunications transport networks or services, other than as provided for in its Schedule; or

(ii) to require a Member (or to require a Member to oblige service suppliers under its jurisdiction) to establish, construct, acquire, lease, operate or supply telecommunications transport networks or services not offered to the public generally.

3. *Definitions*

For the purposes of this Annex:

(a) "Telecommunications" means the transmission and reception of signals by any electromagnetic means.

(b) "Public telecommunications transport service" means any telecommunications transport service required, explicitly or in effect, by a Member to be offered to the public generally. Such services may include, *inter alia*, telegraph, telephone, telex, and data transmission typically involving the real-time transmission of customer-supplied information between two or more points without any end-to-end change in the form or content of the customer's information.

[1] This paragraph is understood to mean that each Member shall ensure that the obligations of this Annex are applied with respect to suppliers of public telecommunications transport networks and services by whatever measures are necessary.

(c) "Public telecommunications transport network" means the public telecommunications infrastructure which permits telecommunications between and among defined network termination points.

(d) "Intra-corporate communications" means telecommunications through which a company communicates within the company or with or among its subsidiaries, branches and, subject to a Member's domestic laws and regulations, affiliates. For these purposes, "subsidiaries", "branches" and, where applicable, "affiliates" shall be as defined by each Member. "Intra-corporate communications" in this Annex excludes commercial or non-commercial services that are supplied to companies that are not related subsidiaries, branches or affiliates, or that are offered to customers or potential customers.

(e) Any reference to a paragraph or subparagraph of this Annex includes all subdivisions thereof.

4. *Transparency*

In the application of Article III of the Agreement, each Member shall ensure that relevant information on conditions affecting access to and use of public telecommunications transport networks and services is publicly available, including: tariffs and other terms and conditions of service; specifications of technical interfaces with such networks and services; information on bodies responsible for the preparation and adoption of standards affecting such access and use; conditions applying to attachment of terminal or other equipment; and notifications, registration or licensing requirements, if any.

5. *Access to and use of Public Telecommunications Transport Networks and Services*

(a) Each Member shall ensure that any service supplier of any other Member is accorded access to and use of public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions, for the supply of a service included in its Schedule. This obligation shall be applied, *inter alia*, through paragraphs (b) through (f).[2]

(b) Each Member shall ensure that service suppliers of any other Member have access to and use of any public telecommunications transport network or service offered within or across the border of that Member, including private leased circuits, and to this end shall ensure, subject to paragraphs (e) and (f), that such suppliers are permitted:

(i) to purchase or lease and attach terminal or other equipment which interfaces with the network and which is necessary to supply a supplier's services;

(ii) to interconnect private leased or owned circuits with public telecommunications transport networks and services or with circuits leased or owned by another service supplier; and

(iii) to use operating protocols of the service supplier's choice in the supply of any service, other than as necessary to ensure the availability of telecommunications transport networks and services to the public generally.

[2] The term "non-discriminatory" is understood to refer to most-favoured-nation and national treatment as defined in the Agreement, as well as to reflect sector-specific usage of the term to mean "terms and conditions no less favourable than those accorded to any other user of like public telecommunications transport networks or services under like circumstances".

(c) Each Member shall ensure that service suppliers of any other Member may use public telecommunications transport networks and services for the movement of information within and across borders, including for intra-corporate communications of such service suppliers, and for access to information contained in data bases or otherwise stored in machine-readable form in the territory of any Member. Any new or amended measures of a Member significantly affecting such use shall be notified and shall be subject to consultation, in accordance with relevant provisions of the Agreement.

(d) Notwithstanding the preceding paragraph, a Member may take such measures as are necessary to ensure the security and confidentiality of messages, subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on trade in services.

(e) Each Member shall ensure that no condition is imposed on access to and use of public telecommunications transport networks and services other than as necessary:

(i) to safeguard the public service responsibilities of suppliers of public telecommunications transport networks and services, in particular their ability to make their networks or services available to the public generally;

(ii) to protect the technical integrity of public telecommunications transport networks or services; or

(iii) to ensure that service suppliers of any other Member do not supply services unless permitted pursuant to commitments in the Member's Schedule.

(f) Provided that they satisfy the criteria set out in paragraph (e), conditions for access to and use of public telecommunications transport networks and services may include:

(i) restrictions on resale or shared use of such services;

(ii) a requirement to use specified technical interfaces, including interface protocols, for inter-connection with such networks and services;

(iii) requirements, where necessary, for the inter-operability of such services and to encourage the achievement of the goals set out in paragraph 7(a);

(iv) type approval of terminal or other equipment which interfaces with the network and technical requirements relating to the attachment of such equipment to such networks;

(v) restrictions on inter-connection of private leased or owned circuits with such networks or services or with circuits leased or owned by another service supplier; or

(vi) notification, registration and licensing.

(g) Notwithstanding the preceding paragraphs of this section, a developing country Member may, consistent with its level of development, place reasonable conditions on access to and use of public telecommunications transport networks and services necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services. Such conditions shall be specified in the Member's Schedule.

6. *Technical Cooperation*

(a) Members recognize that an efficient, advanced telecommunications infrastructure in countries, particularly developing countries, is essential to the expansion of their trade in services. To this end, Members endorse and encourage the participation, to the fullest extent practicable, of developed and developing countries and their suppliers of public telecommunications transport networks and services and other entities in the development programmes of international and regional organizations, including the International Telecommunication Union, the United Nations Development Programme, and the International Bank for Reconstruction and Development.

(b) Members shall encourage and support telecommunications cooperation among developing countries at the international, regional and sub-regional levels.

(c) In cooperation with relevant international organizations, Members shall make available, where practicable, to developing countries information with respect to telecommunications services and developments in telecommunications and information technology to assist in strengthening their domestic telecommunications services sector.

(d) Members shall give special consideration to opportunities for the least-developed countries to encourage foreign suppliers of telecommunications services to assist in the transfer of technology, training and other activities that support the development of their telecommunications infrastructure and expansion of their telecommunications services trade.

7. *Relation to International Organizations and Agreements*

(a) Members recognize the importance of international standards for global compatibility and inter-operability of telecommunication networks and services and undertake to promote such standards through the work of relevant international bodies, including the International Telecommunication Union and the International Organization for Standardization.

(b) Members recognize the role played by intergovernmental and non-governmental organizations and agreements in ensuring the efficient operation of domestic and global telecommunications services, in particular the International Telecommunication Union. Members shall make appropriate arrangements, where relevant, for consultation with such organizations on matters arising from the implementation of this Annex.

APPENDIX II

ANNEX ON NEGOTIATIONS ON BASIC TELECOMMUNICATIONS

1. Article II and the Annex on Article II Exemptions, including the requirement to list in the Annex any measure inconsistent with most-favoured-nation treatment that a Member will maintain, shall enter into force for basic telecommunications only on:

(a) the implementation date to be determined under paragraph 5 of the Ministerial Decision on Negotiations on Basic Telecommunications; or,

(b) should the negotiations not succeed, the date of the final report of the Negotiating Group on Basic Telecommunications provided for in that Decision.

2. Paragraph 1 shall not apply to any specific commitment on basic telecommunications which is inscribed in a Member's Schedule.

APPENDIX III

WORLD TRADE ORGANIZATION

S/L/20
30 April 1996
(96-1750)

Trade in Services

FOURTH PROTOCOL TO THE
GENERAL AGREEMENT ON TRADE IN SERVICES

Members of the World Trade Organization (hereinafter referred to as the "WTO") whose Schedules of Specific Commitments and Lists of Exemptions from Article II of the General Agreement on Trade in Services concerning basic telecommunications are annexed to this Protocol (hereinafter referred to as " Members concerned"),

Having carried out negotiations under the terms of the Ministerial Decision on Negotiations on Basic Telecommunications adopted at Marrakesh on 15 April 1994,

Having regard to the Annex on Negotiations on Basic Telecommunications,

Agree as follows:

1. Upon the entry into force of this Protocol, a Schedule of Specific Commitments and a List of Exemptions from Article II concerning basic telecommunications annexed to this Protocol relating to a Member shall, in accordance with the terms specified therein, supplement or modify the Schedule of Specific Commitments and the List of Article II Exemptions of that Member.

2. This Protocol shall be open for acceptance, by signature or otherwise, by the Members concerned until 30 November 1997.

3. The Protocol shall enter into force on 1 January 1998 provided it has been accepted by all Members concerned. If by 1 December 1997 the Protocol has not been accepted by all Members concerned, those Members which have accepted it by that date may decide, prior to 1 January 1998, on its entry into force.

4. This Protocol shall be deposited with the Director-General of the WTO. The Director-General of the WTO shall promptly furnish to each Member of the WTO a certified copy of this Protocol and notifications of acceptances thereof.

5. This Protocol shall be registered in accordance with the provisions of Article 102 of the Charter of the United Nations.

Done at Geneva this[--- day of month] one thousand nine hundred and ninety-seven, in a single copy in the English, French and Spanish languages, each text being authentic, except as otherwise provided for in respect of the Schedules annexed hereto.

APPENDIX IV

GENERAL AGREEMENT

ON TRADE IN SERVICES

GATS/SC/90
15 April 1994
(94-1088)

THE UNITED STATES OF AMERICA

Schedule of Specific Commitments

(This is authentic in English only)

THE UNITED STATES OF AMERICA - SCHEDULE OF SPECIFIC COMMITMENTS

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
2. COMMUNICATION SERVICES C.TELECOMMUNICATIONS Enhanced Telecommunications Services, as defined by the US Federal Communications Commission in Section 64.702 of the Commission's Rules and Regulations: services, offered over common carrier transmission facilities (i.e., public telecommunications transport services) which employ computer processing applications that: i)act on the format, content code, protocol or similar aspects of the subscriber's transmitted information; or ii)provide the subscriber additional, different, or restructured information; or iii)involve subscriber interaction with stored information.	1) None 2) None 3) None 4)Unbound, except as indicated in the horizontal section	1) None 2) None 3) None 4) None	

Includes the following: h)Electronic Mail i)Voice Mail j)On-line Information and Data Base Retrieval k)Electronic Data Interchange l)Enhanced/Value-added Facsimile Services (including store and forward, store and retrieve) m)Code and Protocol Conversion n)On-line Information and/or Data Processing (including transaction processing) o)Other			

APPENDIX V

WORLD TRADE ORGANIZATION

GATS/SC/90/Suppl.2
11 April 1997

(97-1457)

Trade in Services

THE UNITED STATES OF AMERICA

Schedule of Specific Commitments

Supplement 2

(This is authentic in English only)

This text supplements the entries relating to the Telecommunications section contained on pages 45 to 46 of document GATS/SC/90.

UNITED STATES - SCHEDULE OF SPECIFIC COMMITMENTS

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
2.C.TELECOMMUNICATIONS SERVICES*: 2.C.a.Voice services 2.C.b.Packet-switched data transmission services 2.C.c.Circuit-switched data transmission services 2.C.d.Telex services 2.C.e.Telegraph services 2.C.f.Facsimile services 2.C.g.Private leased circuit services	(1)None (2)None (3)None, other than -Comsat has exclusive rights to links with Intelsat and Inmarsat. -Ownership of a common carrier radio license: Indirect: None Direct: May not be granted to or held by (a)foreign government or the representative thereof (b)non-U.S. citizen or the representative of any non-U.S. citizen	(1)None (2)None (3)None	The United States undertakes the obligations contained in the reference paper attached hereto.
2.C.o. Other Mobile Services Analogue/Digital cellular	(c)any corporation not organized under the laws of the United States or (d)U.S. corporation of which more than 20% of the capital stock is owned or voted by a		

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
services PCS (Personal Communications services) Paging services Mobile data services *Excluding one-way satellite transmissions of DTH and DBS television services and of digital audio services	foreign government or its representative, non-U.S. citizens or their representatives or a corporation not organized under the laws of the United States. (4)Unbound except as indicated by horizontal commitments	(4)Unbound except as indicated by horizontal commitments.	

ATTACHMENT TO THE UNITED STATES SCHEDULE

REFERENCE PAPER

Scope

The following are definitions and principles on the regulatory framework for the basic telecommunications services.

Definitions

Users mean service consumers and service suppliers.

Essential facilities mean facilities of a public telecommunications transport network or service that

(a)are exclusively or predominantly provided by a single or limited number of suppliers; and

(b)cannot feasibly be economically or technically substituted in order to provide a service.

A major supplier is a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of:

(a) control over essential facilities; or

(b) use of its position in the market.

1. Competitive safeguards

1.1 Prevention of anti-competitive practices in telecommunications

Appropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices.

1.2 Safeguards

The anti-competitive practices referred to above shall include in particular:

(a)engaging in anti-competitive cross-subsidization;

(b)using information obtained from competitors with anti-competitive results; and

(c)not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

2. Interconnection

2.1 This section applies to linking with suppliers providing public telecommunications transport networks or services in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier, where specific commitments are undertaken.

2.2 Interconnection to be ensured[1]

Interconnection with a major supplier will be ensured at any technically feasible point in the network. Such interconnection is provided.

(a)under non-discriminatory terms, conditions (including technical standards and specifications) and rates and of a quality no less favourable than that provided for its own like services or for like services of non-affiliated service suppliers or for its subsidiaries or other affiliates;

(b)in a timely fashion, on terms, conditions (including technical standards and specifications) and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require for the service to be provided; and

(c)upon request, at points in addition to the network termination points offered to the majority of users, subject to charges that reflect the cost of construction of necessary additional facilities.

2.3 Public availability of the procedures for interconnection negotiations

The procedures applicable for interconnection to a major supplier will be made publicly available.

2.4 Transparency of interconnection arrangements

It is ensured that a major supplier will make publicly available either its interconnection agreements or a reference interconnection offer.

2.5 Interconnection: dispute settlement

A service supplier requesting interconnection with a major supplier will have recourse, either:

(a) at any time or

(b) after a reasonable period of time which has been made publicly known

to an independent domestic body, which may be a regulatory body as referred to in paragraph 5 below, to resolve disputes regarding appropriate terms, conditions and rates for interconnection within a reasonable period of time, to the extent that these have not been established previously.

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[1]Rural local exchange carriers may be exempted by a state regulatory authority for a limited period of time from the obligations of section 2.2. with regard to interconnection with competing local exchange carriers.

Rural telephone companies do not have to provide interconnection to competing local exchange carriers in the manner specified in section 2.2. until ordered to do so by a state regulatory authority.

3. Universal service

Any Member has the right to define the kind of universal service obligation it wishes to maintain. Such obligations will not be regarded as anti-competitive *per se*, provided they are administered in a transparent, non-discriminatory and competitively neutral manner and are not more burdensome than necessary for the kind of universal service defined by the Member.

4. Public availability of licensing criteria

Where a licence is required, the following will be made publicly available:

(a)all the licensing criteria and the period of time normally required to reach a decision concerning an application for a licence and

(b)the terms and conditions of individual licences.

The reasons for the denial of a licence will be made known to the applicant upon request.

5. Independent regulators

The regulatory body is separate from, and not accountable to, any supplier of basic telecommunications services. The decisions of and the procedures used by regulators shall be impartial with respect to all market participants.

6. Allocation and use of scarce resources

Any procedures for the allocation and use of scarce resources, including frequencies, numbers and rights of way, will be carried out in an objective, timely, transparent and non-discriminatory manner. The current state of allocated frequency bands will be made publicly available, but detailed identification of frequencies allocated for specific government uses is not required.

APPENDIX VI

WORLD TRADE ORGANIZATION

TN/S/O/USA
9 April 2003

(03-2003)

Council for Trade in Services
Special Session

Original: English

COMMUNICATION FROM THE UNITED STATES

Initial Offer

The following initial offer has been received from the delegation of the United States on 31 March with the request that it be circulated to Members of the Council for Trade in Services.

Introduction

1. Recognizing WTO Members commitment in these negotiations to achieve a progressively higher level of liberalization and to provide effective market access, and recognizing that current U.S. commitments under the GATS already provide among the highest levels of effective market access, in response to requests received from Members the United States proposes the following new commitments.

2. Consistent with GATS Article I.3(b) and (c), this offer applies only to services open to private sector participants, unless otherwise indicated, in the attached draft schedules, and does not include the right to acquire or invest in government monopolies supplying services included within any of the sectors or sub-sectors covered by this offer.

3. Under these proposed new GATS obligations, as under current obligations, the United States will continue to be able to establish, maintain, and fully enforce its domestic laws protecting, *inter alia,* consumers, health, safety, and the environment, as well as take actions it considers necessary for the protection of its essential security interests.

4. The United States will consider adopting new obligations under the GATS regarding transparency in regulation of services if other WTO Members are prepared to do so as well. The United States looks forward to work on these issues in bilateral request-offer discussions as well as in other appropriate WTO fora.

5. The United States reserves the right to withdraw, modify, or reduce this offer, in whole or in part, including necessary amendments to the offer regarding listing of tax measures, at any time prior to the conclusion of the negotiations.

6. The United State further reserves the right to make technical changes to this offer and to correct any errors, omissions, or inaccuracies.

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
2. COMMUNICATION SERVICES ~~C.~~ D. Basic Telecommunications Services[1] The transmission between or among points specified by the user, of information of the users choosing, without change in the form or content of the information as sent or received, as defined in 47 U.S.C. 153 (43). Services can be supplied on either a public or private basis, regardless of the facilities used. Services include: a) Voice telephone services b) Packet-switched data transmission services (note:	1) None 2) None 3) None, other than ~~– Comsat has exclusive rights to links with Intelsat and Inmarsat.~~ - Ownership of a common carrier radio license: Indirect: None Direct: May not be granted to or held by (a) foreign government or the representative thereof (b) non-U.S. citizen or the representative of any non-U.S. citizen (c) any corporation not organized under	1) None 2) None 3) None	~~The United States undertakes the obligations contained in the reference paper attached hereto.~~ Supplementing the United States Reference Paper commitments (attached) the United States commits to: Maintain an absence of national government ownership in public telecommunications service suppliers; Maintain a national telecommunications regulatory body independent of executive and legislative branches, which is required to employ transparent procedures in developing rules (including notice and comment) and is empowered to enforce regulations through sanctions, including fines and revocation

[1] ~~Excluding one-way satellite transmissions of DTH and DBS television services and of digital audio services.~~

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
packet switched services classified as information services are not considered basic telecommunications services.) c) Circuit-switched data transmission services	the laws of the United States or (d) U.S. corporation of which more than 20% of the capital stock is owned or voted by a foreign government or its representative, non-U.S. citizens or their representatives or a corporation not organized under the laws of the United States.		of licenses; and Permit licensed suppliers of basic telecommunications services choice of technology used in the supply of services, subject to requirements necessary to fulfill legitimate public policy objectives.
d) Telex services e) Telegraph services f) Facsimile services g) Private leased circuit services [Note: New definition, and same list of services moved to value-added services, below] ~~Enhanced Telecommunications Services, as defined by the US Federal~~	4) Unbound except as indicated by horizontal commitments ~~1) None~~	4) Unbound except as indicated by horizontal commitments. ~~1) None~~	In addition, subject to the national regulatory body's appropriate exercise of forbearance authority under 47 U.S.C 160, and subject to exemptions for certain rural carriers, the United States also commits, with respect to suppliers defined under 47 U.S.C. 153 (26) as local exchange carriers to: Ensure that local exchange carriers, provide dialing parity; Maintain measures prohibiting local exchange carriers from imposing unreasonable or discriminatory conditions or

UNITED STATES – INITIAL OFFER

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
~~Communications Commission in Section 64.702 of the Commission's Rules and Regulations: services, offered over common carrier transmission facilities (i.e., public telecommunications transport services) which employ computer processing applications that:~~ ~~i) act on the format, content code, protocol or similar aspects of the subscriber's transmitted information; or~~	~~2) None~~ ~~3) None~~ ~~4) Unbound, except as indicated in the horizontal section~~	~~2) None~~ ~~3) None~~ ~~4) Unbound, except as indicated in the horizontal section~~	limitations on the resale of public telecommunications services; Ensure that local exchange carriers provide number portability where technically feasible; Ensure that local exchange carriers provide access to poles, ducts, conduits and rights of way at just and reasonable rates and on non-discriminatory terms and conditions to competing basic public telecommunications service suppliers.
~~ii) provide the subscriber additional, different, or restructured information; or~~ ~~iii) involve subscriber interaction with stored information.~~ ~~Includes the following:~~ ~~h) Electronic Mail~~ ~~i) Voice Mail~~			

UNITED STATES – INITIAL OFFER

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
~~j) On-line Information and/or Data Base Retrieval~~ ~~k) Electronic Data Interchange (EDI)~~ ~~l) Enhanced/Value-added Facsimile Services (including store and forward, store and retrieve)~~ ~~m) Code and Protocol Conversion~~ ~~n) On-line Information and/or Data Processing (including transaction processing)~~			

UNITED STATES – INITIAL OFFER

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
E. Information Services (Value-added services) The offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, as defined in 47 USC 153(20). Services include, but are not limited to: - electronic mail - voice mail - on-line Information and/or data base retrieval - Electronic Data Interchange (EDI) - Enhanced/Value-added Facsimile Services - Code and Protocol conversion - on-line information and/or Data processing;	1) None 2) None 3) None 4) Unbound, except as indicated in the horizontal section	1) None 2) None 3) None 4) Unbound, except as indicated in the horizontal section	

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
- packet-switched information services ~~o) Other~~			
Note: services below are redundant, as they are captured in the definition of basic services above. ~~Mobile Services~~ ~~Analogue/Digital cellular services~~ ~~PCS (Personal Communications services)~~ ~~Paging services~~ ~~Mobile data services~~ F. Other Communications Services - Cable services provided over cable systems, as defined in 47 U.S.C. 522(6) and 47 U.S.C. 522(7) - One-way satellite	1) None 2) None 3) None, except that a single company or firm is prohibited from owning a combination of newspapers, radio and/or TV broadcast stations serving the same local market. Radio and television broadcast licenses may not be held by: a	1) None 2) None 3) None	

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
transmission of DTH and DBS television services and of digital audio services. - Radio and Television Broadcast Transmission Services	foreign government; a corporation chartered under the law of a foreign country or of which ~~has a non-US citizen as an officer or director or~~ more than 20 per cent of the capital stock ~~of which~~ is owned or voted by non-US citizens; a corporation chartered under the laws of the United States that is directly or indirectly controlled by a corporation more than 25 per cent of whose capital stock is owned by non-US citizens or a foreign government or a corporation of which any officer or more than 25 per cent of the directors are non-US citizens.		
	4) Unbound, except as indicated in the horizontal section. In addition, US citizenship is required to obtain radio and television licenses.	4) Unbound except as indicated by horizontal commitments	

ATTACHMENT TO THE UNITED STATES SCHEDULE

REFERENCE PAPER

Scope

The following are definitions and principles on the regulatory framework for the basic telecommunications services.

Definitions

Users mean service consumers and service suppliers.

Essential facilities mean facilities of a public telecommunications transport network or service that

(a) are exclusively or predominantly provided by a single or limited number of suppliers; and

(b) cannot feasibly be economically or technically substituted in order to provide a service.

A major supplier is a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of:

(a) control over essential facilities; or

(b) use of its position in the market.

1. Competitive safeguards

1.1 Prevention of anti-competitive practices in telecommunications

Appropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices.

1.2 Safeguards

The anti-competitive practices referred to above shall include in particular:

(a) engaging in anti-competitive cross-subsidization;

(b) using information obtained from competitors with anti-competitive results; and

(c) not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

2. Interconnection

2.1 This section applies to linking with suppliers providing public telecommunications transport networks or services in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier, where specific commitments are undertaken.

2.2 Interconnection to be ensured[1]

Interconnection with a major supplier will be ensured at any technically feasible point in the network. Such interconnection is provided.

(a) under non-discriminatory terms, conditions (including technical standards and specifications) and rates and of a quality no less favorable than that provided for its own like services or for like services of non-affiliated service suppliers or for its subsidiaries or other affiliates;

(b) in a timely fashion, on terms, conditions (including technical standards and specifications) and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require for the service to be provided; and

(c) upon request, at points in addition to the network termination points offered to the majority of users, subject to charges that reflect the cost of construction of necessary additional facilities.

2.3 Public availability of the procedures for interconnection negotiations

The procedures applicable for interconnection to a major supplier will be made publicly available.

2.4 Transparency of interconnection arrangements

It is ensured that a major supplier will make publicly available either its interconnection agreements or a reference interconnection offer.

[1] Rural local exchange carriers may be exempted by a state regulatory authority for a limited period of time from the obligations of section 2.2. with regard to interconnection with competing local exchange carriers.

Rural telephone companies do not have to provide interconnection to competing local exchange carriers in the manner specified in section 2.2. until ordered to do so by a state regulatory authority.

2.5 Interconnection: dispute settlement

A service supplier requesting interconnection with a major supplier will have recourse, either:

(a) at any time or

(b) after a reasonable period of time which has been made publicly known

to an independent domestic body, which may be a regulatory body as referred to in paragraph 5 below, to resolve disputes regarding appropriate terms, conditions and rates for interconnection within a reasonable period of time, to the extent that these have not been established previously.

3. Universal service

Any Member has the right to define the kind of universal service obligation it wishes to maintain. Such obligations will not be regarded as anti-competitive *per se*, provided they are administered in a transparent, non-discriminatory and competitively neutral manner and are not more burdensome than necessary for the kind of universal service defined by the Member.

4. Public availability of licensing criteria

Where a license is required, the following will be made publicly available:

(a) all the licensing criteria and the period of time normally required to reach a decision concerning an application for a license and

(b) the terms and conditions of individual licenses.

The reasons for the denial of a license will be made known to the applicant upon request.

5. Independent regulators

The regulatory body is separate from, and not accountable to, any supplier of basic telecommunications services. The decisions of and the procedures used by regulators shall be impartial with respect to all market participants.

6. Allocation and use of scarce resources

Any procedures for the allocation and use of scarce resources, including frequencies, numbers and rights of way, will be carried out in an objective, timely, transparent and non-discriminatory manner. The current state of allocated frequency bands will be made publicly available, but detailed identification of frequencies allocated for specific government uses is not required.

APPENDIX VII

GENERAL AGREEMENT

ON TRADE IN SERVICES

GATS/SC/42
15 April 1994
(94-1040)

INDIA

Schedule of Specific Commitments

(This is authentic in English only)

INDIA - SCHEDULE OF SPECIFIC COMMITMENTS

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
2.COMMUNICATION SERVICES			
C.Telecommunication Services Data and message transmission services, the following: h)Electronic mail (CPC 7523**) i)Voice mail (CPC 7523**) j)On-line information and data base retrieval (CPC 7523**) l)Enhanced/value added facsimile services, including store and forward, store and retrieve (CPC 7523**) n)On-line information and/or data processing (CPC 843**)	1) None 2) Unbound 3)Only through incorporation with a foreign equity ceiling of 51 per cent 4)Unbound except as indicated in the horizontal section	1) None 2) Unbound 3) None 4)Unbound except as indicated in the horizontal section	

WORLD TRADE ORGANIZATION

GATS/SC/42/Suppl.3
11 April 1997

(97-1391)

Trade in Services

INDIA

Schedule of Specific Commitments

Supplement 3

(This is authentic in English only)

This text supplements the entries relating to the Telecommunication services section contained on page 7 of document GATS/SC/42.

INDIA - SCHEDULE OF SPECIFIC COMMITMENTS

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
2.COMMUNICATION SERVICES C. Telecommunication Services[1] (a) Voice telephone service (CPC 7521**) Limited to local/long distance, for public use over a public telecommunication transport network. Wire based (i.e. for fixed network of subscribers).	(1)Unbound (2)Unbound (3)The service will be permitted to be provided only after the operator gets a licence from the Designated Authority who shall determine the need, if any, for issuance of new licences. The terms and conditions of the licence will be as laid down by the Designated Authority or Government or the prevailing laws in the country. There will be one operator other than Department of Telecommunications (DOT)/Mahanagar Telephone Nigam Ltd. (MTNL) in each service area for a period of 10 years from the grant of licence after which the position will be reviewed.	(1)Unbound (2)Unbound (3)Unbound	The definition and principles on the regulatory framework for the basic telecommunication services subscribed to by India are contained in the annex titled "Explanatory Paper on Additional Commitments by India".

[1]excluding broadcasting services and measures affecting such services. Broadcasting is defined as a form of the uni-directional telecommunications intended for large number of users having appropriate receiving facilities and carried out by means of radio or cable network. This may include sound transmission, television transmission or other types of transmission.

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
	The private operator should be a company registered in India in which total foreign equity must not exceed 25%.		The subject of opening up of national long-distance service beyond service area to competition will be reviewed in the year 1999.
	Service operator will be permitted to provide long distance service within the licensed service area only. Resale of voice telephone services will not be permitted. However, licensees can grant franchises on commission basis for providing public call offices (PCOs) service. The detailed terms and conditions for providing the service will be as per licence conditions. (4) Unbound except as indicated in the horizontal commitments.	(4) Unbound except as indicated in the horizontal commitments	Also, the subject of opening up of international service to competition will be reviewed in the year 2004.
(c)Circuit switched data transmission services (CPC 7523**)	(1) Unbound (2)Unbound (3)Licensed voice telephone service operators	(1) Unbound (2) Unbound (3)Unbound	

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
	will be permitted for transmission of data on the PSTN[2] network in its licensed service area. (4)Unbound except as indicated in the horizontal commitments	 (4)Unbound except as indicated in the horizontal commitments	
(f)Facsimile services (CPC 7521**) (g)Private Leased Circuit Services (CPC 7522**)	(1)Unbound (2)Unbound (3) Licensed voice telephone service operators will be permitted for transmission of facsimile on the PSTN network in its licensed service area. Franchisees of service operators can provide commercial facsimile services (4)Unbound except as indicated in the horizontal commitments (1)Unbound (2)Unbound (3) Licensed voice telephone service operators will be permitted to provide leased circuits	(1) Unbound (2)Unbound (3)Unbound (4)Unbound except as indicated in the horizontal commitments (1)Unbound (2)Unbound (3)Unbound	

[2]PSTN refers to Public Switched Voice Telephone Network which is operated by DoT/MTNL or licensed operator.

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
	to their customers, for their own use within their licensed service area. Resale of such leased circuits will not be permitted. (4)Unbound except as indicated in the horizontal commitments	(4)Unbound except as indicated in the horizontal commitments	
(o)Other Cellular mobile telephone services.	(1)Unbound (2)Unbound (3)The service will be permitted to be provided only after the operator gets a licence from the Designated Authority who shall determine the need, if any, for issuance of new licences. The terms and conditions of the licence will be as laid down by the Designated Authority or Government or the prevailing laws in the country Only digital (GSM) technology will be permitted and this will only be terrestrial based. There will be two cellular service operators in each service area. The position will be reviewed after 10 years. The right of DoT/MTNL to enter into each service area is reserved. The private operator should be a company	(1)Unbound (2)Unbound (3)Unbound	

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
	registered in India in which total foreign equity must not exceed 25%. The detailed terms and conditions for providing the service will be as per licence conditions. (4)Unbound except as indicated in the horizontal commitments.	(4)Unbound except as indicated in the horizontal commitments.	

Explanatory Paper on
Additional Commitments by India

Scope

The following are definitions and principles on the regulatory framework for the basic telecommunications services.

Definitions

Users mean service consumers and service suppliers.

Essential facilities mean facilities of a public telecommunications transport network or service that

(a) are exclusively or predominantly provided by a single or limited number of suppliers; and

(b) cannot feasibly be economically or technically substituted in order to provide a service.

A major supplier is a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of :

(a) control over essential facilities; or

(b) use of its position in the market.

1. Competitive safeguards

Appropriate measures shall be maintained for the purpose of preventing service suppliers from engaging in or continuing in anti-competitive practices of the following type:

(a) using information obtained from competitors with anti-competitive results; and

(b) not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

2. Interconnection

2.1 This section applies to linking with suppliers providing public telecommunications transport network or services in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier, where specific commitments are undertaken.

2.2 Interconnection to be ensured

Interconnection with a major supplier will be ensured at any specified feasible point in the network as indicated in the licence. Such interconnection is provided:

(a)of a quality no less favourable than that provided for its own like services or for like services of non-affiliated service suppliers or for its subsidiaries or other affiliates;

(b)upon request, at points in addition to the network termination points offered to the majority of users as per licence conditions, subject to mutually agreed charges.

2.3 Public availability of the procedures for interconnection negotiations

The procedures applicable for interconnection to a major supplier will be made publicly available.

2.4 Transparency of interconnection arrangements

It will be ensured that a major supplier will make publicly available either its interconnection agreements, or a reference interconnection offer.

2.5 Interconnection: dispute settlement

A service supplier requesting interconnection with a major supplier will have recourse, either:

(a) at any time or

(b) after a reasonable period of time which has been made publicly known

to a domestic regulatory authority to resolve disputes regarding appropriate terms, conditions and rates for interconnection within reasonable period of time, to the extent that these have not been established previously.

3. Universal service

India retains the right to define the kind of universal service obligation it wishes to maintain. Such obligations are not regarded as anti-competitive *per se*, since they would be administered in a transparent and non-discriminatory manner.

4. Public availability of licensing criteria

Where a licence is required, the following will be made publicly available:

(a) All the licensing criteria and

(b) the terms and conditions of individual licences.

5. Regulatory Authority

The decisions of and the procedures used by the regulatory authority shall be impartial with respect to all market participants.

6. Allocation and use of scarce resources

Any procedures for the allocation and use of scarce resources, including frequencies, numbers and rights of way, will be carried out in an objective and timely manner.

WORLD TRADE ORGANIZATION

APPENDIX IX

RESTRICTED

TN/S/O/IND
12 January 2004

(04-0077)

Council for Trade in Services
Special Session

Original: English

INDIA

Conditional Initial Offer

The following communication, dated 16 December 2003, from the delegation of India, is being circulated to the Members of the Council for Trade in Services.

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1. India hereby submits its Conditional Initial Offer under the ongoing negotiations on Trade in Services under Article XIX of the General Agreement on Trade in Services and pursuant to paragraph 15 of the Doha Ministerial Declaration.

2. This offer is conditional on other WTO Members making substantive and satisfactory offers in sectors and modes of supply where India has indicated its interests. India reserves the right to withdraw, modify or reduce any part of this offer and any subsequent conditional offers that could follow, in whole or in part, at any time on or prior to the conclusion of the current Services Negotiations if offers made by India's negotiating partners are not satisfactory. India further reserves the right to make any technical amendments or corrections to this initial conditional offer and any subsequent conditional offer that could follow.

3. This offer is also conditional on the outcome of the negotiations underway on the development of disciplines on domestic regulations.

4. To the extent possible, the individual sectors and sub-sectors are identified in accordance with the Services Sectoral Classification List (MTN.GNS/W/120).

Specific Commitments

5. India has offered to undertake extensive commitments under Modes 1 and 4.

6. In addition to the above, India has substantially improved access in critical service sectors such as Accounting and Book Keeping services, Engineering services, Computer & related services, Medical and Dental services, Services provided by Midwives, Nurses , Physiotherapists and para-medical personnel, Construction and related Engineering services, Financial services, Health services, Tourism services and Maritime Transport services.

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
II. SECTOR – SPECIFIC COMMITMENTS			
1. BUSINESS SERVICES A. <u>Professional Services</u>			
(b) Accounting and Book Keeping Services (CPC 862) **(excluding Auditing Services)**	**1) None** **2) None** **3) Unbound** **4) Unbound except as in horizontal commitments and further subject to the following:** **(a) Access limited to Business Visitors and Independent Professionals only.**	**1) None** **2) None** **3) Unbound** **4) Unbound except as in horizontal commitments and further subject to the following:** **(a) Access limited to Business Visitors and Independent Professionals only.** **(b) Requirement of obtaining professional indemnity insurance from home country of service provider.**	
(e) Engineering Services (CPC 8672)	1) ~~Unbound~~ None 2) ~~Unbound~~ None 3) Only through incorporation with a foreign equity ceiling of 51 per cent **and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.** 4) Unbound except as indicated in the horizontal section	1) ~~Unbound~~ None 2) ~~Unbound~~ None 3) None 4) Unbound except as indicated in the horizontal section	

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
(h) Medical and Dental Services (CPC 9312) **(j) Services provided by Midwives, Nurses, Physiotherapists and para-medical personnel (CPC 93191)**	**1) None for provision of services on provider to provider basis such that the transaction is between established medical institutions covering areas of second opinion to help in diagnosis of cases or in the field of research.** **2) None** **3) Only through incorporation with a foreign equity ceiling of 74 per cent subject to the condition that the latest technology for treatment will be brought in and to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.** **4) Unbound except as indicated in the horizontal section**	**1) None** **2) None** **3) Publicly funded services may be available only to Indian citizens or may be supplied at differential prices to persons other than Indian citizens.** **4) Unbound except as indicated in the horizontal section**	
B. Computer and Related Services (a) Consultancy services related to the installation of computer hardware (CPC 841) (b) Software implementation services (CPC 842) (c) Data processing services (CPC 843) (d) Database services (CPC 844) (e) Maintenance and repair services of office machinery and equipment including computers (CPC 845)	1) ~~Unbound~~ None 2) ~~Unbound~~ None 3) Only through incorporation with a foreign equity ceiling of ~~51%~~ **74 per cent and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.** 4) Unbound except as indicated in the horizontal section	1) ~~Unbound~~ None 2) ~~Unbound~~ None 3) None 4) Unbound except as indicated in the horizontal section	

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
2. COMMUNICATION SERVICES			
C. <u>Telecommunication Services</u>[1] (a) Voice telephone service (CPC 7521**) ~~Limited to local/long distance, for public use over a public telecommunication transport network~~ ~~Wirebased (i.e., for fixed network of subscribers).~~	1) Unbound 2) Unbound 3) The service will be permitted to be provided only after the operator gets a licence from the Designated Authority who shall determine the need, if any, for issuance of new licences. The terms and conditions of the licence will be as laid down by the Designated Authority or Government or the prevailing laws in the country. **In the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.**	1) Unbound 2) Unbound 3) Unbound	The definition and principles on the regulatory framework for the basic telecommunication services subscribed to by India are contained in the annex titled "Explanatory Paper on Additional Commitments by India". ~~The subject of opening up of national long distance service beyond service area to competition will be reviewed in the year 1999.~~
(b) Packet Switched Data Transmission Services (CPC 7523)** **(i) Radio Paging Service (CPC 7523**)**	There will be one operator other than Department of Telecommunications (DOT)/Mahanagar Telephone Nigam Ltd. (MTNL) in each service area for a period of 10 years from the grant of licence after which the position will be reviewed.		~~Also the subject of opening up of international service to competition will be reviewed in the year 2004.)~~

[1] Excluding broadcasting services and measures affecting such services. Broadcasting is defined as a form of the uni-directional telecommunications intended for large number of users having appropriate receiving facilities and carried out by means of radio or cable network. This may include sound transmission, television transmission or other types of transmission.

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
(c) Circuit switched data transmission services (CPC 7523**) (d) **Telex Service (CPC 7523**)** (e) **Telegraph Service (CPC 7522**)** (f) Facsimile Service (CPC 7521** + 7529**) (g) Private Leased Circuit Services (CPC 7522** + 7523**) (o) Others (i) Cellular mobile telephone services. **(ii) V-SAT service**	The private operator should be a company registered in India in which total foreign equity must not exceed 25 per cent. Service operator will be permitted to provide long distance service within the licensed service area only. Resale of voice telephone services is will not be permitted. However, licensees can grant franchises on commission basis for providing public call offices (PCOs) service. The detailed terms and conditions for providing the service will be as per licence conditions. There will be two cellular service operators in each service area, **including one Public Sector operator.** 4) Unbound except as indicated in the horizontal commitments.	4) Unbound except as indicated in the horizontal commitments.	
~~(c) Circuit switched data transmission services (CPC 7523**)~~	~~1) Unbound~~ ~~2) Unbound~~ ~~3) Licensed voice telephone service operators will be permitted for transmission of data on the PSTN[2] network in its licensed service area.~~ ~~4) Unbound except as indicated in the horizontal commitments~~	~~1) Unbound~~ ~~2) Unbound~~ ~~3) Unbound~~ ~~4) Unbound except as indicated in the horizontal commitments~~	

[2] PSTN refers to Public Switched Voice Telephone Network which is operated by DoT/MTNL or licensed operator.

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
~~f) Facsimile services (CPC 7521**)~~	~~1) Unbound~~ ~~2) Unbound~~ ~~3) Licensed voice telephone service operators will be permitted for transmission of facsimile on the PSTN network in its licensed service area. Franchisees of service operators can provide commercial facsimile services~~ ~~4) Unbound except as indicated in the horizontal commitments~~	~~1) Unbound~~ ~~2) Unbound~~ ~~3) Unbound~~ ~~4) Unbound except as indicated in the horizontal commitments~~	
~~(g) Private Leased Circuit Services (CPC 7522**)~~	~~1) Unbound~~ ~~2) Unbound~~ ~~3) Licensed voice telephone service operators will be permitted to provide leased circuits to their customers, for their own use within their licensed service area. Resale of such leased circuits will not be permitted.~~ ~~4) Unbound except as indicated in the horizontal commitments~~	~~1) Unbound~~ ~~2) Unbound~~ ~~3) Unbound~~ ~~4) Unbound except as indicated in the horizontal commitments~~	
Data and message transmission services, the following: (h) Electronic mail (CPC 7523**) (i) Voice mail (CPC 7523**)	1) None 2) Unbound 3) Only through incorporation with a foreign equity ceiling of 51 per cent. **In the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.** 4) Unbound except as indicated in the horizontal section.	1) None 2) Unbound 3) None 4) Unbound except as indicated as indicated in the horizontal section.	

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
(j) On-line information and data base retrieval (CPC 7523**) (l) Enhanced / value added facsimile services, including store and forward, store and retrieve (CPC 7523**) (n) On-line information and/or data processing (CPC 843**)			
~~(o) Other~~ ~~Cellular mobile telephone services.~~	~~1) Unbound~~ ~~2) Unbound~~ ~~3) The service will be permitted to be provided only after the operator gets a licence from the Designated Authority who shall determine the need, if any, for issuance of new licences. The terms and conditions of the licence will be as laid down by the Designated Authority or Government or the prevailing laws in the country~~ ~~Only digital (GSM) technology will be permitted and this will only be terrestrial based.~~ ~~There will be two cellular service operators in each service area. The position will be reviewed after 10 years. The right of DoT/MTNL to enter into each service area is reserved.~~ ~~The private operator should be a company registered in India in which total foreign equity must not exceed 25%.~~	~~1) Unbound~~ ~~2) Unbound~~ ~~3) Unbound~~	

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
	~~The detailed terms and conditions for providing the service will be as per licence conditions.~~ ~~4) Unbound except as indicated in the horizontal commitments.~~	~~4) Unbound except as indicated in the horizontal commitments.~~	
D: <u>Audiovisual Services</u> (a) Motion picture or video tape distribution services (CPC 96113)	1) Unbound 2) Unbound* 3) (i) Only through representative offices which will be allowed to function as branches of companies incorporated outside India. (ii) Import of titles restricted to 100 per year 4) Unbound except as indicated in the horizontal section.	1) Unbound 2) Unbound* 3) Subject to the prescribed authority having certified that the motion picture has: (a) won an award in any of the international film festivals notified by the Ministry of Information & Broadcasting, Government of India; or (b) participated in any of the official sections of the notified international film festivals; or (c) received good reviews in prestigious film journals notified by the Ministry of Information & Broadcasting, Government of India 4) Unbound except as indicated in the horizontal section	

Explanatory Paper on
Additional Commitments by India

Scope

The following are definitions and principles on the regulatory framework for the basic telecommunications services.

Definitions

Users mean service consumers and service suppliers.

Essential facilities mean facilities of a public telecommunications transport network or service that

(a) are exclusively or predominantly provided by a single or limited number of suppliers; and

(b) cannot feasibly be economically or technically substituted in order to provide a service.

A major supplier is a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of :

(a) control over essential facilities; or

(b) use of its position in the market.

1. Competitive-Safeguards

Appropriate measures shall be maintained for the purpose of preventing service suppliers from engaging in or continuing in anti-competitive practices of the following type:

(a) using information obtained from competitors with anti-competitive results; and

(b) not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

2. Interconnection

2.1 This section applies to linking with suppliers providing public telecommunications transport network or services in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier, where specific commitments are undertaken.

2.2 Interconnection to be ensured

Interconnection with a major supplier will be ensured at any specified feasible point in the network as indicated in the licence. Such interconnection is provided:

(a) of a quality no less favourable than that provided for its own like services or for like services of non-affiliated service suppliers or for its subsidiaries or other affiliates;

(b) upon request, at points in addition to the network termination points offered to the majority of users as per licence conditions, subject to mutually agreed charges.

2.3 Public availability of the procedures for interconnection negotiations

The procedures applicable for interconnection to a major supplier will be made publicly available.

2.4 Transparency of interconnection arrangements

It will be ensured that a major supplier will make publicly available either-its interconnection agreements, or a reference interconnection offer.

2.5 Interconnection: dispute settlement

A service supplier requesting interconnection with a major supplier will have recourse, either:

(a) at any time or

(b) after a reasonable period of time which has been made publicly known

to a domestic-authority to resolve disputes regarding appropriate terms, conditions and rates for interconnection within reasonable period of time, to the extent that these have not been established previously.

3. Universal service

India retains the right to define the kind of universal service obligation it wishes to maintain. Such obligations are not regarded as anti-competitive per se, since they would be-administered in a transparent and non-discriminatory manner.

4. Public availability of licensing criteria

Where a licence is required, the following will be made publicly available:

(a) All the licensing criteria, and

(b) The terms and conditions of individual licences.

5. Regulatory Authority

~~The decisions of and the procedures used by the regulatory authority shall be impartial with respect to all market participants.~~

The regulatory body is separate from, and not accountable to, any supplier of basic telecommunications services. The decisions of, and the procedures used by, regulators shall be impartial with respect to all market participants.

6. Allocation and use of scarce resources

Any procedures for the allocation and use of scarce resources, including frequencies, numbers and rights of way, will be carried out in an objective and timely manner. **The current state of allocated frequency bands will be made publicly available, but detailed identification of frequencies allocated for specific government uses is not required.**

INDIA – FINAL LIST OF ARTICLE II (MFN) EXEMPTIONS

Sector or Sub-sector	Description of measure indicating its inconsistency with Article II	Countries to which the measure applies	Intended duration	Conditions creating the need for the exemption
2.C Telecommunication services – International Service	Measure including the application of different accounting rates for different operators/countries covered by International Telecommunication Services Agreements between Videsh Sanchar Nigam Limited and various foreign operators.	Countries covered by International Telecommunication Services Agreements between Videsh Sanchar Nigam Limited and foreign operators.	Indefinite	On account of bilateral agreements between Videsh Sanchar Nigam Limited and various foreign operators dealing with various aspects of cooperation.
2.C Telecommunication services – International Service	Measures including the application of different accounting rates for different neighbouring countries covered by Telecommunication Agreements entered into by the Government of India with governments of neighbouring countries.	Neighbouring countries (Pakistan, Bangladesh, Nepal and Bhutan)	Indefinite	On account of bilateral agreements with governments of neighbouring countries.

Sector or Sub-sector	Description of measure indicating its inconsistency with Article II	Countries to which the measure applies	Intended duration	Conditions creating the need for the exemption
AUDIOVISUAL SERVICES	Measures which define norms for co-production of motion pictures and television programmes with foreign countries and grant national treatment to motion pictures and television programmes co-produced with foreign countries which maintain a co-production agreement with India.	All countries	Indefinite	The agreements aim at the promotion of cultural exchange.
SHIPPING (a) Cargo sharing between bilateral partners	Equality in freight liftings originating in the ports of partners to the agreement and equality in freight earnings	Bulgaria, Pakistan and the United Arab Republic	Indefinite	In the context of overall trade relations.
(b) Cargo Reservations	Cargo reservation under the UN Code of Conduct for Liner Conferences, Sharing of cargo between the national lines of contracting states and third country lines in the ratio of 40:40:20 as provided in the Liner Code.	All countries	Indefinite	To fulfil obligations under the covention.
RECREATIONAL SERVICES	Waiver on the prohibition of sale of lottery tickets in India.	Bhutan	Indefinite	It is part of a comprehensive bilateral agreement between India and Bhutan.

APPENDIX X

WORLD TRADE ORGANIZATION

GATS/SC/56/Suppl.2
11 April 1997

(97-1326)

Trade in Services

MEXICO

Schedule of Specific Commitments

Supplement 2

(This is authentic in Spanish only)

This text supplements the Telecommunication services section contained on pages 20 to 22 of document GATS/SC/56.

MEXICO - SCHEDULE OF SPECIFIC COMMITMENTS

Modes of supply: (1)Cross-border supply(2)Consumption abroad(3)Commercial presence (4)Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
2.C.TELECOMMUNICATIONS SERVICES			
Telecommunications services supplied by a facilities based public telecommunications network (wire-based and radioelectric) through any existing technological medium, included in subparagraphs (a), (b), (c), (f), (g) and (o).	(1)None, except the following: International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport (SCT).	(1)None	Mexico undertakes the obligations contained in the reference paper attached hereto.
	(2) None	(2)None	
Radio broadcasting, cable television, satellite transmissions of DTH and DBS services and of audio digital services are excluded.	(3)A concession[1] from the SCT is required. Only enterprises established in conformity with Mexican law may obtain such a concession. Concessions for spectrum frequency bands for specific uses will be granted by public invitation to tender. Foreign governments may not participate in an enterprise set up in accordance with	(3)None	

[1]Concession: The granting of title to install, operate or use a facilities-based public telecommunications network.

Modes of supply: (1)Cross-border supply(2)Consumption abroad(3)Commercial presence (4)Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
	Mexican law nor obtain any authorization to provide telecommunications services.		
	Direct foreign investment up to 49 per cent is permitted in an enterprise set up in accordance with Mexican law. Telecomunicaciones de Mexico (Telecomm) has exclusive rights to links with Intelsat and Inmarsat. Services other than international long-distance services which require use of satellites must use Mexican satellite infrastructure until the year 2002. (4)Unbound, except as indicated in the horizontal section.	(4)Unbound, except as indicated in the horizontal section.	
(a)Voice telephony (CPC 75211, 75212) (b)Packet-switched data transmission services (CPC 7523**)	(1) None, except as indicated in 2.C.1. (2) None (3)As indicated in 2.C.3.	(1) None (2) None (3) None	

(c)Circuit-switched data transmission services (CPC 7523**)	(4)Unbound, except as indicated in the horizontal section.	(4)Unbound, except as indicated in the horizontal section.	
(f)Facsimile services (CPC 7521** + 7529**)	(1) None, except as indicated in 2.C.1. (2)None	(1) None (2)None	
	(3)As indicted in 2.C.3. A permit issued by the SCT is required in order to provide a public facsimile service. Only enterprises set up in accordance with Mexican law may obtain such a permit. (4)Unbound, except as indicated in the horizontal section.	(3) None (4)Unbound, except as indicated in the horizontal section.	
(g)Private leased circuit services (CPC 7522** + 7523**)	(1)None, except as indicated in 2.C.1. (2) None (3)As indicated in 2.C.3. Operators of private networks wishing to exploit services commercially must obtain a concession from the SCT, whereupon such networks assume the character of public networks.	(1)None (2) None (3) None	

	(4)Unbound, except as indicated in the horizontal section.	(4)Unbound, except as indicated in the horizontal section.	
(o)Other -Paging services (PC 75291)	(1) None, except as indicated in 2.C.1. (2) None (3) As indicated in 2.C.3. (4)Unbound, except as indicated in the horizontal section.	(1) None (2) None (3) None (4)Unbound, except as indicated in the horizontal section.	
-Cellular telephone services (75213**) on the "A" and "B" bands[2]	(1)None, except as indicated in 2.C.1. (2)None (3)As indicated in 2.C.3. Foreign investment in excess of 49 per cent of an enterprise's capital will be permitted following a favourable decision by the Foreign Investment Commission (4)Unbound, except as indicated in the horizontal section.	(1)None (2)None (3)None (4)Unbound, except as indicated in the horizontal section.	

[2]Frequencies 825-835/870-880 and 835-845/880-890 Mhz.

-Commercial agencies[3]	(1)None, except as indicated in 2.C.1. (2)None (3)None, except: A permit issued by the SCT is required. Only enterprises set up in accordance with Mexican law may obtain such a permit. Foreign governments may not participate in an enterprise set up in accordance with Mexican law nor obtain any authorization to provide telecommunications services. Except where specifically approved by the SCT, public telecommunications network concessionaires may not participate, directly or indirectly, in the capital of a commercial agency.	(1)None (2)None (3)None	
	The establishment and operation of commercial agencies is invariably subject to the relevant regulations. The SCT will not issue permits for the establishment of a commercial agency until the corresponding		

[3]Agencies which, without owning transmission means, provide third parties with telecommunications services by using capacity leased from a public network concessionaire.

	regulations are issued. (4)Unbound, except as indicated in the horizontal section.	 (4)Unbound, except as indicated in the horizontal section	

REFERENCE PAPER

Scope

The following are principles and definitions on the regulatory framework for the basic telecommunications services.

Definitions

Users mean service consumers and service suppliers.

Essential facilities mean facilities of a public telecommunications network of service that:

(a)Are exclusively or predominantly provided by a single or limited number of suppliers; and

(b)cannot feasibly be economically or technically substituted in order to provide a service.

A major supplier is a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of:

(a) Control over essential facilities; or

(b)use of its position in the market.

1. Competitive safeguards

1.1 Prevention of anti-competitive practices in telecommunications

Appropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices.

1.2 Safeguards

The anti-competitive practices referred to in the above paragraph shall include in particular:

(a)Engaging in anti-competitive cross-subsidization;

(b)using information obtained from competitors with anti-competitive results; and

(c)not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

2. Interconnection

2.1 This section applies, on the basis of the specific commitments undertaken, to linking with suppliers providing public telecommunications transport networks or services in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier.

2.2 Interconnection to be ensured

Interconnection with a major supplier will be ensured at any technically feasible point in the network. Such interconnection is provided:

(a) Under non-discriminatory terms, conditions (including technical standards and specifications) and rates and of a quality no less favourable than that provided for its own like services or for like services of non-affiliated service suppliers or for its subsidiaries or other affiliates;

(b) in a timely fashion, on terms, conditions (including technical standards and specifications) and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require for the service to be provided; and

(c) upon request, at points in addition to the network termination points offered to the majority of users, subject to charges that reflect the cost of construction of necessary additional facilities.

2.3 Public availability of the procedures for interconnection negotiations

The procedures applicable for interconnection to a major supplier will be made publicly available.

2.4 Transparency of interconnection arrangements

It is ensured that a major supplier will make publicly available either its interconnection agreements or a reference interconnection offer.

2.5 Interconnection dispute settlement

A service supplier requesting interconnection with a major supplier will have recourse, either:

(a) At any time; or

(b) after a reasonable period of time which has been made publicly known

to an independent domestic body, which may be a regulatory body as referred to in paragraph 5, to resolve disputes regarding appropriate terms, conditions and rates for interconnection within a reasonable period of time, to the extent that these have not been established previously.

3. Universal service

Any Member has the right to define the kind of universal service obligation it wishes to maintain. Such obligations will not be regarded as anti-competitive *per se*, provided they are administered in a transparent, non-discriminatory and competitively neutral manner and are not more burdensome than necessary for the kind of universal service defined by the Member.

4. Public availability of licensing criteria

Where a licence is required, the following will be made publicly available:

(a) All the licensing criteria and the period of time normally required to reach a decision concerning an application for a licence; and

(b) the terms and conditions of individual licences.

The reasons for the denial of a licence will be made known to the applicant upon request.

5. Independent regulators

The regulatory body is separate from, and not accountable to, any supplier of basic telecommunications services. The decisions of and the procedures used by regulators shall be impartial with respect to all market participants.

6. Allocation and use of scarce resources

Any procedures for the allocation and use of scarce resources, including frequencies, numbers and rights of way, will be carried out in an objective, timely, transparent and non-discriminatory manner. The current state of allocated frequency bands will be made publicly available, but detailed identification of frequencies allocated for specific government uses is not required.

ORGANIZACIÓN MUNDIAL

DEL COMERCIO

GATS/SC/56/Suppl.2
11 de abril de 1997

(97-1326)

Comercio de Servicios

MÉXICO

Lista de compromisos específicos

Suplemento 2

(Esta lista es auténtica en español únicamente)

Esta lista complementa la sección sobre los servicios de telecomunicaciones contenidas en las páginas 19 a 21 del documento GATS/SC/56.

{PRIVATE }Modos de suministro: 1) Suministro transfronterizo 2) Consumo en el extranjero 3) Presencia comercial 4) Presencia de personas físicas

Sector o subsector	Limitaciones al acceso a los mercados	Limitaciones al trato nacional	Compromisos adicionales
2.C. SERVICIOS DE TELECOMUNICACIONES Los servicios de telecomunicaciones, suministrados por una red pública de telecomunicaciones basada en infraestructura (alámbrica y radio-eléctrica) a través de cualquier medio tecnológico actual, incluidos en las literales a), b), c), f), g) y o). Se excluyen los servicios de radiodifusión, de televisión por cable, de transmisión satelital de DTH y DBS, y de audio digital.	1)Ninguna, excepto la siguiente: el tráfico internacional debe ser enrutado a través de las instalaciones de una empresa con una concesión otorgada por la Secretaría de Comunicaciones y Transportes (SCT). 2)Ninguna 3)Se requiere concesión[1] otorgada por SCT. Sólo empresas constituidas conforme a la ley mexicana pueden obtener tal concesión. Las concesiones sobre bandas de frecuencias del espectro para usos determinados se otorgarán mediante licitación pública. Los gobiernos extranjeros no podrán participar en una empresa constituida conforme a las leyes mexicanas, ni obtener autorización alguna para prestar servicios de telecomunicaciones. Se permite la participación de la inversión extranjera directa hasta 49 por ciento en una empresa constituida conforme a las leyes mexicanas.	1)Ninguna 2)Ninguna 3)Ninguna	México adopta las obligaciones contenidas en el documento de referencia anexo a la presente.
	Telecomunicaciones de México (Telecomm) tiene		

1 Concesión: Se refiere al otorgamiento de un título para instalar, operar o explotar una red pública de telecomunicaciones basada en infraestructura.

{PRIVATE }Modos de suministro: 1) Suministro transfronterizo 2) Consumo en el extranjero 3) Presencia comercial 4) Presencia de personas físicas

Sector o subsector	Limitaciones al acceso a los mercados	Limitaciones al trato nacional	Compromisos adicionales
	los derechos exclusivos para los enlaces con Intelsat e Inmarsat. Los servicios distintos a los de larga distancia internacional que requieran del uso de satélites hasta el año 2002 deberánutilizar infraestructura satelital mexicana. 4)No consolidado, excepto lo indicado por los compromisos horizontales.	4)No consolidado, excepto lo indicado por los compromisos horizontales.	
a.Servicios de telefonía (CCP 75211, 75212) b.Servicios de transmisión de datos con conmutación de paquetes (CCP 7523**) c.Servicios de transmisión de datos con conmutación de circuitos (CCP 7523**)	1)Ninguna, excepto la indicada en 2.C.1). 2)Ninguna 3)Lo indicado en 2.C.3) 4)No consolidado, excepto lo indicado por los compromisos horizontales.	1)Ninguna 2)Ninguna 3)Ninguna 4)No consolidado, excepto lo indicado por los compromisos horizontales.	
f.Servicios de facsímil (CCP 7521**+7529**)	1)Ninguna, excepto la indicada en 2.C.1). 2)Ninguna 3)Lo indicado en 2.C.3). Se requiere de pemiso expedido por SCT para prestar servicio público de facsímil. Sólo	1)Ninguna 2)Ninguna 3)Ninguna	

Sector o subsector	Limitaciones al acceso a los mercados	Limitaciones al trato nacional	Compromisos adicionales
	empresas constituidas conforme a las leyes mexicanas pueden obtener dicho permiso. 4)No consolidado, excepto lo indicado por los compromisos horizontales.	4)No consolidado, excepto lo indicado por los compromisos horizontales.	
g.Servicios de circuitos privados arrendados (CCP 7522**+7523**)	1)Ninguna, excepto lo indicado en 2.C.1). 2)Ninguna 3)Lo indicado en 2. C. 3). Los operadores de redes privadas que pretendan explotar comercialmente servicios, deberán obtener concesión otorgada por SCT, adoptando tales redes el carácter de red pública de telecomunicaciones. 4)No consolidado, excepto lo indicado por los compromisos horizontales.	1)Ninguna 2)Ninguna 3)Ninguna 4)No consolidado, excepto lo indicado por los compromisos horizontales.	
o.Otros -Servicios de localización de personas (CCP75291)	1)Ninguna, excepto lo indicado en 2.C.1). 2)Ninguna 3)Lo indicado en 2.C.3). 4)No consolidado, excepto lo indicado por los	1)Ninguna 2)Ninguna 3)Ninguna 4)No consolidado, excepto lo indicado por	

{PRIVATE }Modos de suministro: 1) Suministro transfronterizo 2) Consumo en el extranjero 3) Presencia comercial 4) Presencia de personas físicas

Sector o subsector	Limitaciones al acceso a los mercados	Limitaciones al trato nacional	Compromisos adicionales
	compromisos horizontales.	los compromisos horizontales.	
- Servicios de telefonía celular (75213**) en las bandas "A" y "B" [2]	1)Ninguna, excepto lo indicado en 2.C.1). 2)Ninguna 3)Lo indicado en 2.C.3). Se permitirá inversión extranjera superior al 49% del capital de una empresa, previa resolución favorable de la Comisión Nacional de Inversión Extranjera. 4)No consolidado, excepto lo indicado por los compromisos horizontales.	1)Ninguna 2)Ninguna 3)Ninguna 4) No consolidado, excepto lo indicado por los compromisos horizontales.	
- Comercializadoras [3]	1) Ninguna, excepto lo indicado en 2.C.1). 2) Ninguna 3) Ninguna excepto: Se requiere permiso otorgado por SCT. Sólo empresas constituidas conforme a la ley mexicana pueden obtener tal permiso.	1)Ninguna 2)Ninguna 3)Ninguna	

2 Frecuencias 825-835/870-880 y 835-845/880-890 Mhz.

3 Empresas que, sin ser propietarias o poseedoras de medios de transmisión, proporcionan a terceros servicios de telecomunicaciones mediante el uso de capacidad arrendada de un concesionario de redes públicas de telecomunicaciones.

Sector o subsector	Limitaciones al acceso a los mercados	Limitaciones al trato nacional	Compromisos adicionales
	Los gobiernos extranjeros no podrán participar en una empresa constituida conforme a las leyes mexicanas, ni obtener autorización alguna para prestar servicios de telecomunicaciones. Salvo aprobación expresa de la SCT, los concesionarios de redes públicas de telecomunicaciones no podrán participar, directa o indirectamente, en el capital de una empresa comercializadora. El establecimiento y operación de las empresas comercializadoras deberá sujetarse invariablemente a las disposiciones reglamentarias respectivas. SCT no otorgará permisos para el establecimiento de una comercializadora hasta emitir la reglamentación correspondiente. 4)No consolidado, excepto lo indicado por los compromisos horizontales.	4)No consolidado, excepto lo indicado por los compromisos horizontales.	

DOCUMENTO DE REFERENCIA

Alcance

A continuación se presentan definiciones y principios relativos al marco regulatorio de los servicios básicos de telecomunicaciones.

Definiciones

Usuarios, significa consumidores del servicio y proveedores del servicio.

Recursos esenciales, significa los recursos de una red pública de telecomunicaciones de transporte o de servicios que:

(a)son exclusivamente o predominantemente suministradas por un solo proveedor o por un número limitado de proveedores; y

(b)no pueden ser fácilmente sustituidas económica o técnicamente para poder suministrar un servicio.

Proveedor principal, es aquel proveedor que tiene la capacidad de afectar materialmente los términos de participación en el mercado relevante de servicios básicos de telecomunicaciones (teniendo en cuenta el precio y la oferta), como resultado del:

(a) control sobre los recursos esenciales; o

(b) uso de su posición en el mercado.

1. Salvaguardas Competitivas

1.1 Prevención de prácticas anticompetitivas en telecomunicaciones:

Se mantendrán las medidas apropiadas, con el propósito de prevenir que, los proveedores que se constituyan, de manera individual o conjunta, como proveedor principal, se involucren en, o continúen con prácticas anticompetitivas.

1.2 Salvaguardas:

Las prácticas anticompetitivas a las que se refiere el párrafo anterior incluirán_en particular:

(a)incurrir en subsidios cruzados anticompetitivos;

(b)utilizar información obtenida de la competencia con resultados anticompetitivos; y

(c)no poner a disposición de otros proveedores de servicios, de manera oportuna, información técnica relativa a recursos esenciales e información comercialmente relevante que les sea necesaria para suministrar servicios.

2. Interconexión

2.1 Esta sección es aplicable a la conexión con los proveedores de redes públicas de telecomunicaciones de transporte o de servicios a fin de permitir a los usuarios de un proveedor comunicarse con los usuarios de otro proveedor y tener acceso a los servicios suministrados por algún otro proveedor, respecto de los cuales se contraigan compromisos específicos.

2.2 Interconexión a ser garantizada

La interconexión con un proveedor principal quedará asegurada en cualquier punto técnicamente factible de la red. Tal interconexión se llevará a cabo:

(a)bajo términos, condiciones, (incluyendo normas técnicas y especificaciones) y tarifas no discriminatorios y con calidad no menos favorable que la proporcionada para servicios similares propios, o para servicios similares de proveedores de servicios no afiliados o para sus subsidiarias u otras filiales:

(b)de manera oportuna, en términos, condiciones (incluyendo normas técnicas y especificaciones) y tarifas basadas en costos que sean transparentes, razonables, económicamente factibles y que sean lo suficientemente desagregadas para que el proveedor no necesite pagar por componentes o recursos de la red que no se requieran para que el servicio sea suministrado; y

(c)previa solicitud, en puntos adicionales a los puntos terminales de la red ofrecidos a la mayoría de los usuarios, sujeta a un precio que refleje el costo de la construcción de las instalaciones adicionales necesarias.

2.3 Disponibilidad pública de procedimientos para las negociaciones de interconexión

Los procedimientos aplicables para la Interconexión a un proveedor principal deberán estar a disposición del público.

2.4 Transparencia de los acuerdos de interconexión

Garantizar que el proveedor principal hará públicamente disponibles sus acuerdos de interconexión o una oferta de interconexión de referencia.

2.5 Interconexión: Solución de controversias

Un proveedor de servicios que solicite la interconexión con un proveedor principal podrá interponer recurso:

(a)en cualquier momento, o

(b)después de un periodo razonable de tiempo que se haya dado a conocer públicamente

a una entidad nacional independiente, la cual puede ser un órgano regulador al que se hace referencia en el párrafo 5, para resolver las disputas relacionadas con los términos, condiciones y tasas apropiados para la interconexión dentro de un plazo razonable, en la medida en que éstos no hayan sido establecidos previamente.

3. Servicio universal

Cualquier Miembro tiene el derecho de definir el tipo de obligación de servicio universal que desee mantener. Tales obligaciones no serán consideradas como anticompetitivas *per se* siempre y cuando sean administradas de manera transparente, no discriminatoria y competitivamente neutrales y no sean mas onerosas de lo necesario para el tipo de servicio universal definido por el Miembro.

4. Disponibilidad pública de los criterios de licenciamiento

Donde se requiera una licencia lo siguiente deberá ser públicamente disponible:

(a)todos los criterios para el licenciamiento y los plazos normalmente requeridos para llegar a una decisión concerniente a la solicitud de una licencia, y

(b)los términos y condiciones para licencias individuales.

Las razones para la negativa a una solicitud de licencia deberá hacerse del conocimiento del solicitante a petición del mismo.

5. Reguladores Independientes

La entidad reguladora será independiente de todo proveedor de servicios básicos de telecomunicaciones y no responderá ante él. Las decisiones y los procedimientos empleados por los reguladores serán imparciales con respecto a todos los participantes en el mercado.

6. Atribución y uso de recursos escasos

Cualquier procedimiento para la atribución y el uso de recursos escasos, incluyendo frecuencias, números y derechos de vía será llevado a cabo de manera objetiva, oportuna, transparente y no discriminatoria. La situación actual de las bandas de frecuencia atribuidas, deberá hacerse públicamente disponible no requiriéndose la identificación detallada de frecuencias atribuidas para propósitos gubernamentales.

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